Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

JACK GREEN, individually and as Trustee, STANLEY SIMON, Trustee, and NORMA EVANS,

*Petitioners,*

*v.*

NUVEEN ADVISORY CORP., JOHN NUVEEN AND CO., INC., RICHARD J. FRANKE, DONALD E. SVEEN, NUVEEN MASSACHUSETTS PREMIUM INCOME MUNICIPAL FUND, NUVEEN INSURED MUNICIPAL OPPORTUNITY FUND, INC., NUVEEN INSURED PREMIUM INCOME MUNICIPAL FUND, INC., NUVEEN PREMIUM INCOME MUNICIPAL FUND 2, INC., NUVEEN INSURED PREMIUM INCOME MUNICIPAL FUND 2, and NUVEEN PREMIUM INCOME MUNICIPAL FUND 4, INC.,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

The Investment Company Act (the "Act"), 15 U.S.C. § 80a-1, *et seq.*, seeks to "mitigate and, so far as is feasible, eliminate" the operation of investment companies "in the interest of . . . investment advisers . . . rather than in the interest of . . . such companies' security holders." Section 36(b) of the Act places investment advisors under "a fiduciary duty . . . with respect to the receipt of compensation. . . . " Nonetheless, the investment advisors to leveraged, tax-exempt municipal bond funds, which utilize leverage raised by issuing senior equity to the extent of approximately thirty-five per cent of their total assets, have compensation arrangements whereby they are paid on a percentage of their funds' "net assets" including all assets attributable to the proceeds of senior equity leverage, thus making a substantial portion of their compensation dependant upon the continued utilization of leverage.

The questions presented are:

1. Whether the design and utilization of a compensation arrangement by an investment advisor to an investment company which provides the advisor with economic incentive and opportunity to manage the company's leverage for the maximization of its own compensation, rather than for the benefit of the company's investors, constitutes a violation of the advisor's fiduciary duty under Section 36(b) of the Act.

2. Whether the Court of Appeals' requirement that deliberate mismanagement by the advisor for its own financial advantage be pleaded and proven renders any remedy illusory for an advisor's self-dealing with respect to leverage management.

3. Whether the Court under Section 36(b)(2) of the Act should accord any consideration whatsoever to the approval by the boards of directors of investment companies of such a compensation arrangement where the boards relied on the investment advisor for recommendations as to leverage, where the advisor never recommended a reduction in leverage, and where the directors never considered a reduction in leverage.

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Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

## OPINIONS BELOW

The district court's opinion (per Guzman, D.J.), denying petitioners' motion for partial summary judgment and granting respondents' motions for summary judgment (Pet. App. B at 15a), is not reported in F. Supp. 2d, but is published at Fed. Sec. L. Rep. P 91,549 and 2001 WL 1035652. The court of appeals' opinion (per Flaum, C.J., joined by Bauer and Ripple, Cir. J.), affirming (Pet. App. A at 1a), is published at 295 F.3d 738. The district court's earlier opinion (per Bucklo, D.J.) granting in part and denying in part respondents' motions to dismiss for failure to state a claim upon which relief can be granted (Pet. App. C at 37a) is published at 186 F.R.D. 486.

## STATEMENT OF JURISDICTION

The court of appeals entered its opinion and order on July 8, 2002. Petitioners invoke this Court's jurisdiction under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

The provisions of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.*, relevant to this petition are reprinted in the Appendix D at 54a.

## STATEMENT OF THE CASE

1. *Introduction*: The Investment Company Act of 1940 (the "Act"), 15 U.S.C. §§ 80a-1, *et seq.*, declares that "the public interest is adversely affected . . . (2) when investment companies are . . . managed . . . in the interest of . . . investment advisors . . . rather than in the interest of . . . such companies' security holders" and directs that it is to be interpreted in accordance with its policy and purposes "to mitigate and, so far as feasible, to eliminate, the conditions numerated." 15 U.S.C. § 80a-1(b). In furtherance of that goal, Congress in 1970 amended the Act by adding § 36(b), 15 U.S.C. § 35(b) which provides, in relevant part that:

> The investment adviser . . . shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services . . . paid by such . . . investment company . . . to such adviser or any affiliated person.

Respondent Nuveen Advisory Corp. ("Nuveen"), the investment advisor to the Fund Respondents in this case, caused them to enter into compensation agreements with it, pursuant to which the Respondent Funds pay compensation to Nuveen on the basis of a percentage of the entire net assets of the Funds, including assets attributable to the Funds' preferred stock leverage. As a result, approximately *one third* of Nuveen's compensation is dependant upon maintaining the Funds in a substantially fully leveraged position at all times. Nuveen thus has strong financial motivation to maintain leverage regardless of whether its maintenance is in the best interests of the Funds' Common Shareholders. This compensation arrangement is fundamentally different

from that employed by the advisors to most debt-leveraged investment companies, whose compensation basis excludes assets attributable to leverage from the measure of the advisor's compensation, thus leaving the advisor free of any financial interest in the employment of leverage.

The Court of Appeals, while acknowledging that Section 36(b) is not limited to "excessive fee" cases, concluded that the mere existence of a conflict of interest inherent in Nuveen's compensation arrangement is not inconsistent with its fiduciary duty unless Plaintiffs' can show that an actual conflict existed and that the advisor abused its position. Petitioners' Appendix ("Pet. App.") A, pp. 8a-11a.

The Court of Appeals' decision calls for review and correction by this Court because the Court of Appeals decided an important question of federal law that has not been, but should be, settled by this Court. The Court of Appeals' decision misconceives and emasculates the investor protection provided by Section 36(b), one of the keystone provisions by which Congress sought to require that investment advisors discharge their duties with fidelity to the interests of their investor/shareholders, rather than to their own financial interests.

*First*, by permitting the advisors to investment companies to employ compensation arrangements which create conflicting interests between the advisor and the funds' investors with respect to fund management, the Court of Appeals holding invites precisely the self-interested management by advisors which § 1 of the Act declares to be contrary to the national public interest.

*Second*, by denying any remedy for breach of fiduciary duty in such circumstances unless investors are able to prove that the advisor deliberately mis-managed the fund for its own financial advantage, the Court of Appeals holding renders any remedy for self-interested management resulting from such compensation arrangements illusory.

*Third*, by according great weight to the approval by the Funds' boards of directors of the compensation arrangements between the Funds and the advisor where the boards relied on the advisor for recommendations as to leverage, where the advisor never recommended a reduction in leverage, and where the directors never considered a reduction, the court of appeals ignored all the circumstances that undergirded the boards' approval and sanctioned self-dealing as long as the boards approve.

2. *The Facts*: In 1991-1993, Nuveen's corporate affiliate created the six investment company Respondents (the "Funds"). R. 44, 11-14. Petitioners are owners of common stock in the Funds. R. 44, 19-22. Nuveen acts as the investment advisor to the Funds and administers the Funds' business affairs, provides the Funds with office facilities, equipment, and clerical, bookkeeping and administration services. R. 133, Ex. 1, 32-33; Ex. 2, 28-29; Ex. 3, 23-24; Ex. 4, 25-26; Ex. 6, 31-32. The Funds pay a fee to Nuveen for its advisory services and facilities. R. 133, Ex. 1, 33; Ex. 2, 28; Ex. 3, 24; Ex. 4, 26; Ex. 6, 31.

Each of the Funds is a registered, closed-end investment company, which invests principally in municipal bonds that

are exempt from Federal income taxation and provide tax-exempt income to the shareholders. R. 133, Exhibits 1-6, 1-4. Shares of the Funds are traded on the national stock exchanges and are not redeemable by the Funds. R. 132, *Plaintiffs' Memorandum*, Addendum A (hereinafter, "Addendum A"). The Funds' primary objective is to generate current income, exempt from federal taxation, and the secondary objective is to enhance portfolio value relative to the bond market. *See*, for example, R. 133, Exhibit ("Ex.") 1, p. 4.

The Funds' prospectuses stated that each of the Funds intended to use "leverage." R. 133, Ex. 1, 23; Ex. 2, 20; Ex. 3, 15; Ex. 4, 16; Ex. 5, 4-5; Ex. 6, 21. The assets of the Funds are "leveraged" by the issuance of preferred shares which pay dividends based on shorter-term rates. R. 133, Ex. 1, 23; Ex. 2, 20; Ex. 3, 15; Ex. 4, 16; Ex. 5, 4-5; Ex. 6, 21. Leverage is a process by which the assets of the Common Shareholders are subordinated to the rights of Preferred Shareholders who provide assets to purchase additional long-term bonds. R. 132, Addendum A. The long-term bonds purchased in this manner often pay higher rates of interest than the Funds pay in dividends to Preferred Shareholders; the difference, after the fees and costs of the advisor, is then paid to the Common Shareholders. R. 132, Addendum A. The leverage of each Fund represents approximately 35% of its capital. R. 133, Ex. 1, 23; Ex. 2, 20; Ex. 3, 15; Ex. 4, 15; Ex. 5, 4-5; Ex. 6, 21.

Leverage affects not only the income of the Funds, but also the value of the Common Shareholder's investment. R. 132, Addendum A. Because the preferred shareholders

always have the first claim on the Fund's assets, any drop in the *value* of its assets is borne solely by the Common Shareholders. R. 133, Ex. 1, 23; Ex. 2, 20; Ex. 3, 15; Ex. 4, 16; Ex. 6, 21-22. Thus, the loss to Common Shareholders when asset value drops is greater when there is leverage than when there is not. *Id.* This affects the value of the Common Shareholders' investment and the achievement of the Funds' stated investment objective of enhancing asset value. R. 132, *Plaintiffs Statement of Material Facts,* 10; R. 133, Ex. 1, 10. As a result, in periods of rising interest rates, it is incumbent on the advisor to consider and balance the worth of increased revenue, derived from leverage, against the decline in value of the Funds' assets (bonds) in such periods. R. 132, *Plaintiffs' Memorandum*, 2-3; R. 133, Ex. 15, 25-27, 29-30.

The Funds' prospectuses stated that the maintenance of leverage presented certain risks to Common Shareholders, including that:

> . . . since any decline in the net asset value of the Fund's investments would be borne entirely by Common Shareholders, the effect of leverage in a declining market would result in a greater decrease in net asset value to Common Shareholders than if the Fund were not leveraged, which would likely be reflected in a greater decline in the market price for Common Shares.

R. 133, Ex. 1, 23; Ex. 2, 20; Ex. 3, 15; Ex. 4, 15; Ex. 6, 21.

Having disclosed the risks associated with leverage, the Funds' prospectuses assured potential shareholders that

> In the event of an increase in shorter-term rates or other changed market conditions to the point where the Fund's leverage could adversely affect Common Shareholders as noted above, or in anticipation of such changes, the *Fund . . . may also attempt to reduce the degree to which it is leveraged* by redeeming or otherwise purchasing preferred shares. (emphasis supplied).

R. 133, Ex. 1, 24; Ex. 2, 21; Ex. 3, 16; Ex. 4, 17; Ex. 6, 22-23.

Thus, although the Funds in their stated objectives represented that they would address the value of the Fund, as well as its interest income, it was communicated to investors that this would not be done to the exclusion of the effect of leverage.

By leveraging the Funds to the fullest extent practically feasible, Nuveen received a fee approximately 35% larger than would be the case if Nuveen had ever eliminated leverage. R. 132, *Plaintiffs' Statement of Material Facts*, 4, 9. In fact, Nuveen never reduced the leverage on the Funds, but maintained the original leverage, and continued to charge a fee on the value of the leverage, *even in years when the market value of Common Shares declined drastically*. R. 132, *Plaintiffs' Statement of Material Facts*, 4-5; R. 133, Ex. 15, 25-29; R. 133, Ex. 11, 36, lines 16-17. In contrast, debt-leveraged funds — using debt rather than preferred shares — which did not receive advisory compensation based in part on leverage reduced leverage during the period of decline in bond values. R. 132, *Plaintiffs' Statement of Material Facts*, 5; R. 133, Ex. 15, 29-30. Nuveen never once, during the entire existence of the Funds, reduced the Funds'

use of leverage or recommended to the Funds' boards that there be a reduction in leverage.[1] R. 130, Ex. 34, 27; Ex. 35, 54. Nor, did Nuveen ever recommend to the Funds' boards of directors that the Funds reduce leverage to preserve asset value. R. 133, Ex. 14, 143-144; R. 130, Ex. 34, 23-24, 27-28; Ex. 35, 54, 100.

Quarterly, Nuveen reported to the directors on the leverage. R. 130, Ex. 34, 17-18, 25. The Funds' boards of directors relied on Nuveen for recommendations as to leverage. R. 130, Ex. 34[2], 11-12, 18-19, 20, 23-24, 27, 56; R. 130, Ex.35, 83-84. The decision to leverage is effectively within the control of the advisor. R. 132, *Plaintiffs' Statement of Material Facts*, 4 ¶ 16; R. 133, Ex. 14, 54, lines 18-19. The Funds' boards of directors never considered a reduction in leverage, except for the single instance in which continuation of dividends was threatened.[3]

3. *The Opinions Below*. On September 10, 2002, the district court granted Respondents' motion for summary judgment and denied Petitioner's cross motion for partial summary judgment on liability. Petitioners' Appendix

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1. The single time that Nuveen suggested the possibility of a reduction in leverage was when the precipitous decline in values of bonds posed the threat of requiring suspension of dividends to common shareholders for exceeding the Funds' maximum permitted ratio of leverage to common equity capital. R. 132, *Plaintiffs' Statement of Material Fact*, 5, 8; R. 133, Ex. 14, 140-144; R. 130, Ex. 35, 99-100.

2. Ms. Rosenheim was a disinterested director of approximately 50 Nuveen funds. R. 130, Ex. 34, 13.

3. *See* n.1, *supra*.

("Pet. App.") B, 15a. The district court recognized that the scope of Section 36(b) is not confined to excessive compensation claims (Pet. App. B, pp. 24a-25a), but concluded that the conflict inherent in Nuveen's compensation arrangement did not constitute a breach of Nuveen's fiduciary duty because (1) all closed-end leveraged municipal bond funds employ the same basis for calculating their fees and Congress could not have intended to condemn that industry practice[4] in enacting Section 36(b) in 1970 (Pet. App. B, 25a-26a), (2) authority decided under § 404(a)(1)(A)(i) of ERISA, 29 U.S.C. § 1104(a)(1)(A)(I) demonstrates that Congress did not intend to make the existence of conflicting interests a *per se* breach of statutorily created fiduciary duties (Pet. App. B, 30a) and (3) that the Funds' disinterested directors had approved the compensation arrangement (Pet. App. B, 31a).

On July 8, 2002, the Court of Appeals affirmed the district court's grant of summary judgment. The Court concluded that (1) "mere existence" of the conflict of interest inherent in the challenged fee arrangement does not constitute, by itself, a violation of Nuveen's fiduciary duties under Section 36(b) of the Act (Pet. App. A, 8a) and (2) to prove a violation under Section 36(b) Plaintiffs must show an actual conflict of interest and evidence of abuse by the advisor (Pet. App. A, 10a-11a).

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4. The Court was in error in presuming such intent because there were no closed-end, non-taxable, leveraged funds in existence in 1970. The tax law changes which permitted creation of muncipal bond funds did not occur until 1976. R. 133, Ex. 15, "Response and Rebuttal," pp. 5-6. Leveraged municipal bond funds did not begin to come into existence until years later. The Respondent Funds were not created until the early *1990's*. R. 44, 11-14.

The Court of Appeals concluded that while an *abuse* of the inherent conflict of interest in the compensation arrangement between Nuveen and the Funds "may violate" Section 36(b), "its mere existence does not." (Pet. App. A, 8a). The Court of Appeals required that Plaintiff shareholders must demonstrate, not only that an actual conflict of interest existed between the advisor and shareholders, but also present evidence that the advisor actually abused its position by mismanaging the Funds in order to maintain its own compensation, thus breaching its fiduciary duty under Section 36(b) (Pet. App. A, 10a-11a). The Court of Appeals explained its view that, apart from allegations of excessive fees under Section 36(b), a Common Shareholder's Section 36(b) claim might survive summary judgment only:

> in the *improbable* case that: 1) the advisor to a closed-end, equity-leveraged fund with an asset-based compensation scheme received additional fees by increasing or maintaining leverage when it *predicted* that short-term interest rates would exceed long-term rates for a *protracted period of time* causing the common shareholders to lose current income; and 2) *the advisor, not the board of directors, made final leveraging decisions* . . .

(Pet. App. A, 9a n.8) (emphasis supplied).

In so doing, the Court of Appeals predicated its holding on congressional intent and legislative history, finding that Section 36(b) contained no explanation of the term "fiduciary duty" and that the 1970 revisions of the ICA were "not intended" to generally revise the practices of the investment company industry. (Pet. App.A, 8a).

However, the Court of Appeals failed to recognize the distinction between the advisor's inherent and unavoidable conflict of interest in determining the *amount* of its compensation and the wholly different situation presented by the fee arrangements in this case which create a gratuitous and *avoidable* conflict of interest by creating a financial incentive for the advisor to manage the funds — specifically the leverage — in its own interest. Likewise, the Court of Appeals failed to recognize that the legislative history that it relied upon addresses the more common and predominant issue of determining the *amount* of advisory compensation and does not indicate that Congress intended to permit investment advisors to create compensation arrangements that provide gratuitous incentives to self-dealing.

The Court of Appeals' requirement that an actual instance of self-dealing in violation of the advisor's fiduciary duty be proven is unexceptionable in cases of determination of the *amount* of advisory compensation but is unnecessary and destructive of the Act's objectives, when applied to gratuitous conflicts such as that presented by this case. Congress plainly recognized that the advisor's conflict with respect to the determination of the amount of its compensation was both inherent and unavoidable as is the case with anyone accepting an engagement to act as a fiduciary. While the fees of trustees and executors are subject to judicial examination and approval, the law imposes no presumption that the fee charged by the fiduciary is improper. As a result, it would have been inappropriate as well as impractical to subject advisors to liability because of the mere existence of that unavoidable conflict and Congress clearly intended that the remedy for breach of fiduciary duty be limited, in such instances, to circumstances where the advisor had actually used its position of dominance to obtain an amount

of compensation which was overreaching. *See* S. Rep. No. 91-184 (1969), reprinted in U.S.C.C.A.N. 4897, 4901; *Gartenberg v. Merrill Lynch Asset Mgmt.*, 694 F.2d 923, 925-928 (2d Cir. 1982).

Such reasoning, however, has no application to the entirely different circumstances presented by a compensation arrangement which creates a conflicting interest not inherent in the advisor/fund relationship, which is unnecessary and easily avoidable and which establishes a financial incentive for the advisor to manage the fund for its own benefit. Such arrangements are at war with the core objective of the Act:

> to mitigate and, so far as feasible, to eliminate . . . [the management of investment companies] in the interest of. . . . advisors. . . . rather than in the interest of. . . . such companies' security holders.

15 U.S.C. § 80a-1(b)

Thus, with regard to a compensation arrangement which provides an incentive to the advisor to maintain leverage, regardless of whether beneficial to the investors, just as with a compensation arrangement which encouraged the advisor to churn the fund's portfolio or to invest in issues which its affiliates had underwritten, there is no need to await or require proof of some instance where the incentive has actually caused the advisor to engage in intentional self-dealing. Such arrangements serve no legitimate purpose, are wholly unnecessary to the advisor/fund relationship, are invitations to self-dealing by the advisor and are facially inconsistent with its fiduciary position. Nothing in the legislative history suggests that Congress intended to permit such arrangements

so long as it could not be proven that they had resulted in actual and intentional self-dealing. Indeed, such authority as there is, dealing with gratuitous conflicts of interest in Section 36(b) cases, is consistent with Petitioners' position.

In *Galfand v. Chestnutt Corp.*, 545 F.2d 807, 811 (2d. Cir. 1976) the Second Circuit affirmed imposition of Section 36(b) liability on an advisor that failed to disclose material facts in connection with a proposed amendment to its compensation agreement. The Court held that such failure was, in and of itself, a breach of the advisor's fiduciary duty and did not pause to consider the issue of whether the proposed amendment was itself unreasonable or overreaching.

Thus, while the lower federal courts have properly considered the inherent conflict over the *amount* of advisory compensation to be "potential" and non-actionable unless it results in compensation which is plainly overreaching (*See Gartenberg, supra* at 978) they have applied traditional principles of fiduciary conduct to other acts or arrangements involving avoidable conflicts of interest. *Rosenfeld v. Black*, 445 F.2d 1337 (2d Cir. 1971); *Meyer v. Oppenheimer Management Corp.*, 764 F.2d 76, 87 (2d Cir. 1985).

This petition for a writ of certiorari followed.

## REASONS FOR GRANTING THE PETITION

The petition should be granted for two reasons.

*First*, the Seventh Circuit's Judgment is irreconcilable with the fundamental purposes of both the Act as a whole, and Section 36(b) in particular, and permits and, indeed, invites advisory compensation arrangements which have no purpose or affect other than to encourage self-interested management of investment companies by their advisors; one of the evils expressly identified by Section 1(b) of the Act, which the Act seeks to eliminate insofar as possible. 15 U.S.C. § 80a-1(b), Pet. App. D, 54a-55a.

*Second*, the Seventh Circuit's requirement that petitioners prove an actual instance, within the damage period, when Nuveen deliberately mismanaged the funds for its own advantage, renders illusory even the limited remedy which that Court recognized.

### 1. The Decision Below is Inconsistent with the Fundamental Values and Purposes of the Both the Investment Company Act and Section 36(b) thereof.

This case comes squarely within Rule 10(c) of this Court's Rules as a case that calls for the exercise of the Court's discretion to review when:

> . . . a . . . court of appeals has decided an important question of federal law that has not been, but should be, settled by this Court. . . .

With a large and growing portion of the Nation's capital, including its citizens' pension and retirement savings, invested through investments in registered investment companies, and with public confidence in the integrity of the financial markets fragile at best, there can be little doubt that the public interest in achieving the Investment Company Act's objectives, including the objective of mitigating and, so far as feasible, eliminating the management of investment companies by their advisors for their own benefit and at the expense of the investors is, if anything, greater than it was either when Congress originally promulgated the Act in 1940 or when it amended it by adding the provisions of Section 36(b) in 1970.

Congress enacted a series of provisions to achieve the Act's purposes, prohibiting some transactions between investment companies and their advisors entirely, requiring that investment company boards have substantial proportions of directors who are not affiliated with the advisor, regulating the capital structure of investment companies and prohibiting breaches of their fiduciary duties by investment advisors. These provisions are part of a regulatory structure, each provision of which was intended by Congress to contribute to achieving the Act's ultimate objective that registered investment companies be managed honestly and in the interests of the investors, rather than to benefit the financial services enterprises that create them, sell investments in them to the public and derive their continuing revenues from the fees paid by the investors for the provision of investment advisory and management services. The provisions of the Act are intended to work together to promote those ends and no single provision is to be disregarded or left un-enforced merely because other provisions of the Act may also have application to the circumstances of some particular abuse.

The Act was enacted to eliminate the abuses that Congress perceived in the industry, *S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186, 84 S. Ct. 275, 280 (1963), and to address the SEC's findings that:

> Investment advisors could not 'completely perform their basic function . . . furnishing to clients on a personal basis competent, unbiased, and continuous advise regarding the sound management of their investments . . . unless all conflicts of interest between the investment counsel and the client were removed.'

Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, On Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong.2d Sess. 1 (hereinafter "SEC Report").

Section 36 of the Act, as originally enacted, provided a remedy for "gross abuse of trust" by advisors but a further study of the investment company industry concluded that that section was not effective in providing sufficient protection to investment company shareholders. Wharton School of Finance and Commerce, A Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong. 2d Sess. (1962). This led to the enactment of the Investment Company Amendments Act of 1970 which, *inter alia*, modified original Section 36 (and, as amended, made it Section 36(a)) by prohibiting breaches of trust involving "personal misconduct" and by adding Section 36(b) which placed the advisor under a fiduciary duty with respect to the receipt of compensation.

Congress could, of course, have simply prohibited advisors from receiving excessive compensation or required that their compensation be no more than "reasonable" but despite early versions of the amendment to the latter effect, it did not do so. Instead, it created an obviously broader requirement by imposing on advisors "a fiduciary duty with respect to the receipt of compensation for services." It thus made the advisor a fiduciary with respect to its compensation arrangements and prohibited arrangements that are inconsistent with that fiduciary duty.

Just as the SEC Report had found, even before the enactment of the original Act in 1940, that the removal of "all conflicts of interest" was necessary to ensure that advisors would properly perform their duties, so it is at the core of fiduciary responsibilities generally that fiduciaries must avoid any avoidable circumstances which create interests for them which conflict with their fiduciary responsibilities and which might incline them to further their own interests at the expense of their beneficiaries. That is the very basis of the "rule of undivided loyalty" for trustees. Scott on Trusts, 4th Ed., § 170.15, *accord*, Bogart on Trusts, 3d Ed., § 543 at pp. 475-76:

> Reasons behind the establishment of the loyalty rule by equity are that it is generally, if not always, humanly impossible for the same person to act fairly in two capacities and on behalf of two interests in the same transaction. Consciously or unconsciously he will favor one side as against the other, where there is or may be a conflict of interest. If one of the interests involved is that of the trustee personally, selfishness is apt to lead him to give himself an advantage.

It is daunting to conceive of an area where an advisor may be more strongly or directly tempted to serve its own interests than with respect to the arrangement by which it receives compensation for its services. While the advisor's conflict with respect to the amount of its compensation is inherent in the relationship and thus unavoidable, it does not follow that all possible conflicts of interest created by an advisor's compensation arrangement are similarly inherent and unavoidable or that they must be tolerated except when they lead to actual intentional self-dealing. The record before the district court on the motions for summary judgment clearly showed that many debt-leveraged investment companies compensated their advisors on a basis which entirely excluded leverage or its proceeds from the measure of advisory compensation and which thus left such advisors with no financial stake at all in the management of leverage. The record established no circumstance unique or peculiar to leveraged municipal bond funds, which requires that their advisors' compensation be calculated on a basis which includes leverage. The conflict inherent in Nuveen's compensation arrangement was thus shown to be entirely unnecessary. This compensation arrangement, which predicates nearly a *third* of Nuveen's advisory income on the leverage alone, serves no purpose other than to provide more than substantial motivation to Nuveen to manage the leverage of the Funds with primary attention to its own income.

The Court of Appeals Judgment approving this arrangement simply invites self-dealing by advisors who include leverage in the measure of their advisory compensation. Such arrangements are inimical to the Act's objective of eliminating, to the extent possible, the occasions for self-dealing by investment company advisors and the Court of Appeals Judgment thus warrants review and correction by this Court in order to preserve the Act's effectiveness and vindicate its policies.

**2. The Court of Appeals' Requirement that Deliberate Mismanagement by the Advisor for its Own Financial Advantage be Pleaded and Proven Renders Any Remedy for an Advisor's Self-Dealing with Respect to Leverage Management Illusory.**

The Court of Appeals concluded, not only that a compensation scheme like Nuveen's which "could create an incentive for advisors to keep an investment fund leveraged to an extent that may not be best for the fund's common shareholders does not, *by itself*, create a breach of fiduciary duty" under Section 36(b) (Pet. App. A, 9a)(emphasis supplied), but that the Funds' investors in this case could not maintain their action unless they produced evidence that Nuveen "actually abused its position . . . " (Pet. App. A, 10a-11a) and that "an actual conflict existed" (Pet. App. A, 11a). The Court of Appeals, in stating that Petitioners failed to show that Nuveen "predicted" the interest rate changes that occurred in 1994 when the Funds continued to maintain a fully leverage position, concluded that Petitioners' argument that Nuveen made a decision that negatively impacted the Common Shareholders in order to increase compensation failed. (Pet. App. A, 11a). These requirements effectively insulate advisors such as Nuveen, which elect to receive their advisory compensation on a basis which includes Fund leverage, from any liability even when they, in fact, maintain full leverage at all times, guaranteeing the one-third of their income which is derived from the leverage, even during market conditions in which it would be in the best interests of Fund investors to reduce leverage. (Pet. App. A, 11a; R. 133, Exhibits 15, 25-29).

Section 36(b)(1) places upon plaintiffs the burden of proving a breach of fiduciary duty by the advisor. If a breach can *only* be established by proof that the advisor intentionally mismanaged the fund's leverage for the purpose of maximizing its own fees, then plaintiffs have an impossible burden of proving not only the state of the advisor's knowledge and awareness with respect to the likely future movement of interest rates, but also with respect to the advisor's subjective motivation for its actions or recommendations. Investors can prove neither since both are matters peculiarly within the knowledge of the advisor and the advisor is unlikely to candidly acknowledge either its belief that the financial circumstances militated in favor of reducing leverage or its motivation to ignore such circumstances in order to serve its own interests. As a result, the *only* potentially effective remedy is to proscribe compensation arrangements which provide the occasion and motivation for such self-dealing.

The record before the district court was replete with evidence which demonstrated the futility of any attempt to prove Nuveen's *actual belief*, at any time, in the existence of circumstances which militated in favor of reducing leverage, much less to establish Nuveen's venially motivated maintenance of leverage in disregard of same. While Nuveen clearly acknowledged in the Funds' prospectuses that circumstances could exist in which it could anticipate increasing interest rates and in which it thus might be appropriate to reduce the Funds' leverage (R. 133, Exhibits 1, 24; Exhibits 2, 21; R. 133, Ex. 14, 82), Nuveen's officers and managers and retained experts firmly maintained that, despite the statements in the prospectuses, the future movement of interest rates was not sufficiently predictable to serve as a basis for prudent leverage management decisions

and, moreover, that even if the increases in interest rates that actually occurred during 1994 had been predictable, anticipation of such increases would not have justified reducing the Funds' leverage because they thought that it was more important to preserve, without reduction, comparatively small amounts of tax exempt income from bond interest payments than to avoid market losses in portfolio value of several times the amount of tax exempt income preserved.

Moreover, it was undisputed that leverage management decisions are matters of judgment, about which reasonable and informed opinions can differ. Because it is virtually impossible to refute the merits, much less the subjective sincerity, of an advisor's professed opinions about such matters of judgment, it is all the more important that the advisor, who determines or strongly influences such decisions, have no personal interest in their resolution and be in a position to exercise a truly disinterested judgment. In this case, no evidence could have been adduced to refute the beliefs which Nuveen's employees maintained they held or the sincerity of their claimed value judgment as to the comparative costs and benefits of maintaining a fully leveraged position in a declining bond market. Moreover, a fact finder's mere disbelief in the credibility of their testimony would not have constituted evidence to the contrary or served to satisfy Petitioners' burden of proving a breach of Nuveen's fiduciary duties.

It follows that a remedy for breach of the advisor's fiduciary duty that requires proof that (1) an actual conflict existed, (2) the advisor actually abused its position, and (3) the advisor "predicted" market conditions in which it made a decision that negatively impacted the Common

Shareholders in order to maintain its compensation, is, in reality, no remedy at all. The advisor, unless it admits to its own wrongdoing, can always maintain that it did not believe that circumstances warranted reducing leverage and that, regardless, its actions were motivated by its own subjective conclusion that any benefits from reducing leverage would be outweighed by its disadvantages. In such event, the advisor will be entitled to summary judgment because plaintiffs will be unable to adduce affirmative evidence to the contrary. That was the burden that the Court of Appeals Judgment imposed upon Petitioners here. In this respect as well, the Court of Appeals' Judgment warrants review and correction by this Court in order to prevent the subversion and defeat of the Act's objective of preventing self-dealing by investment advisors.

### 3. The Court of Appeals Erroneously Relied on the Failure of the Independent Directors to Act on the Issue of Leverage.

The directors of the Funds' boards never once discussed or considered the wisdom of leverage[5], but because the compensation arrangement with Nuveen had once been approved by the independent directors of the Funds, the Court of Appeals held that, because "Congress expressly ordered that we give board of director approval 'such consideration . . . as is deemed appropriate under all the circumstances'," 15 U.S.C. § 80a-35(b)(2), this potential defense of the advisor Nuveen was another factor that supported the District Court's

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5. Except in circumstances not here relevant — when a question arose whether leverage might, as a matter of compliance with the law, have to be reduced to allow the Funds to maintain the payment of dividends. *See* n.1, *supra*; R. 130, Ex. 35, 99-100.

grant of summary judgment. While it is true that the directors of the Funds held the ultimate authority on the issue of whether and how much leverage was appropriate, the record is replete with evidence that Nuveen had never presented for review by the directors the question of whether or how much leverage was prudent and that the directors had never considered the issue. Because Nuveen undeniably had a substantial financial interest in maintaining leverage, it should have identified periodic consideration of the Funds' utilization of leverage for the directors' independent review and supervision. It uniformly failed to do so, and failed to emphasize to the directors the particular need for directorial attention to leverage occasioned by its own self-interest in the issue. In these circumstances, the boards' original approval of the compensation arrangement was entitled to little, if any, weight and was surely an insufficient basis for considering such approval as dispositive, on summary judgment, of its propriety. The whole point of the deference to be given to approval by the board of directors of a compensation arrangement of an ICA fund is to weigh its reasons for a course of action. Here, there is no evidence of any nature that the directors ever even discussed or considered the issue. In this respect, both the District Court and the Court of Appeals misconstrued an important legal issue under the ICA.

## CONCLUSION

For the reasons above set forth, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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# APPENDIX

**APPENDIX A — OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DATED AND FILED JULY 8, 2002**

**In the**
**UNITED STATES COURT OF APPEALS**
**For the Seventh Circuit**

No. 01-3671

JACK GREEN, INDIVIDUALLY AND AS TRUSTEE,
STANLEY SIMON, TRUSTEE, AND NORMA EVANS,

*Plaintiffs-Appellants*,

*v.*

NUVEEN ADVISORY CORP.,

*Defendant-Appellee.*

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 97 C 5255—**Ronald A. Guzman**, *Judge*.

Argued May 15, 2002—Decided July 8, 2002

Before FLAUM, *Chief Judge*, and BAUER and RIPPLE, *Circuit Judges*.

FLAUM, *Chief Judge*. The plaintiffs in this case are common shareholders of six closed-end, tax-exempt municipal bond funds. They allege that Nuveen, the funds' investment adviser, breached its fiduciary duty under § 36(b) of the Investment Company Act of 1940 ("ICA" or "the Act")

by receiving compensation based on a percentage of the daily net assets of the funds. Such an arrangement, plaintiffs contend, creates an inherent conflict of interest in violation of the Act. The district court granted summary judgment in favor of the defendant, finding that the plaintiffs failed to produce evidence establishing a breach of fiduciary duty under § 36(b). For the reasons stated herein, we affirm the decision of the district court.

## I. Background

The six funds at issue are closed-end,[1] tax-exempt, leveraged[2] companies that invest in tax-free municipal bonds. The stated primary objective of the funds is to provide shareholders current income exempt from regular federal income tax. The stated secondary objective is to enhance

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1. A closed-end investment company, unlike a traditional open-end mutual fund, has fixed capitalization and may sell only the number of shares of its own stock as originally authorized. It does not redeem its securities at the option of the shareholder. Shares of a closed-end fund are traded on a secondary market; that is, its stock, like that of any publicly owned corporation, is usually listed on a national exchange. The most pertinent difference between open- and closed-end investment companies is that closed-end funds are authorized under the ICA to use leverage to increase the stream of current income through the sale of preferred stock so long as there is 200% asset coverage for these securities. 15 U.S.C. § 80a-18(a)(2).

2. Leverage exists "when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return." Securities Trading Practices of Registered Investment Companies, IC-10666 (Apr. 18, 1979).

portfolio value relative to the municipal bond market "through investments in tax-exempt Municipal Obligations that, in the opinion of the adviser, are underrated or undervalued or that represent municipal market sectors that are undervalued."

Each of the funds uses leverage to increase the amount of current income generated. That is, each of the funds issues preferred stock, used as a leveraging tool, as well as common stock.[3] The sale of common stock provides the majority of the capital with which the funds purchase long-term municipal bonds. The proceeds from the sale of preferred stock, sold at a dividend rate that is based upon short-term tax-exempt interest rates, are invested into additional long-term municipal bonds that pay rates of return that exceed the preferred-share dividend amount. The difference between the dividend paid to the preferred shareholders and these long-term interest rates amounts to additional income to common shareholders. So long as the long-term rates exceed the short-term dividend rates, which they do under normal market conditions, common shareholders receive greater current income than they would if the identical fund were not

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3. The six Nuveen funds are leveraged through the issuance of a preferred class of stock. The Act also permits closed-end funds to attain leverage by issuing debt securities so long as 300% asset coverage exists. 15 U.S.C. § 80a-18(a)(1). Debt-leveraged investment companies generally compute advisory compensation without regard to leverage because debt is considered a liability under Generally Accepted Accounting Principals ("GAAP") and is subtracted from gross assets when net assets—upon which the advisers' fees are based—are determined.

leveraged.[4] It is undisputed in this case that the long-term always exceeded the short-term rates. The Nuveen funds were leveraged for the entire time period in question.

Being a common shareholder of a leveraged investment company is not without risks. The dividends and values of preferred shares are set; the holders of preferred shares always have a prior claim on the funds' assets. Therefore, a decrease in the value of those assets is borne only by the holders of common shares. Generally, the more highly leveraged the fund, the greater the risk of loss resulting from decreased portfolio value. Each of the six funds' prospectuses informed its common shareholders that leverage creates increased volatility in the value of their shares.[5]

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4. The greater the difference between long-term and short-term rates, the greater the increase in current income to the common shareholders.

5. This inherent risk that accompanies investing in closed-end leveraged funds was disclosed to shareholders in other publications as well. For example, the April 30, 1995 semiannual report for three of the funds states:

> This period of unusually high volatility and uncertainty has brought home a basic fact about fixed-income securities: interest rates are subject to change, and sometimes the changes can have dramatic effects on net asset values. At Nuveen, we believe that the best approach to tax-free investing . . . is to focus on quality and income dependability. By this standard . . . your Fund continued to meet its objectives well, providing an attractive level of tax-free income while holding

(Cont'd)

*Appendix A*

Under the ICA, each investment company must have a board of directors, at least 40% of which is disinterested from the fund and its advisers. A majority of the directors of each of the funds at issue in this case is unaffiliated with Nuveen. The directors maintained ultimate control over the extent of the funds' leverage and the decisions as to whether to deleverage at a given time; they did, however, rely upon Nuveen for recommendations on leverage decisions.

Nuveen operates and manages the funds in question. Its compensation is based on a percentage of the daily net assets of the funds, including the value of assets attributable to outstanding preferred shares.[6] Thus, assuming the number of outstanding common shares remains fixed, the more highly leveraged the fund, the higher Nuveen's compensation. The six funds issued preferred shares equaling approximately

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(Cont'd)

> portfolio values well in light of market conditions. . . . The fact that your Fund is leveraged means that its net asset value per share will be somewhat more sensitive to interest rate changes . . . than unleveraged funds. . . . Through our value approach to investing . . . we will continue to pursue . . . attractive tax-free income and the enhancement of portfolio value relative to the municipal bond market.

6. According to GAAP, net assets equal assets minus liabilities. Equity, such as preferred stock, is not subtracted from assets in this computation. To account for economies of scale, the percentage of the daily net asset value that Nuveen receives decreases as that value increases. In 1995, Nuveen received .65 of 1% for the first $125 million in net assets, .6375 for the next $125 million, .625 for the next $250 million, .6125 for the next $500 million, .6 for the next billion dollars, and .5875 for net assets over $2 billion.

35% of the funds' total assets to create leverage. Because an adviser's services and costs increase, to some extent, as its fund's assets increase, almost all investment companies and 100% of the 202 current closed-end, leveraged municipal bond funds, base adviser compensation on net or total assets.

## II. Discussion

We review the district court's grant of summary judgment *de novo,* construing all of the facts and reasonable inferences that can be drawn from those facts in favor of the nonmoving party. *See Central States, Southeast & Southwest Areas Pension Fund v. Fulkerson*, 238 F.3d 891, 894 (7th Cir. 2001). A grant of summary judgment is appropriate if the pleadings, affidavits, and other supporting materials leave no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c).

The logic of the plaintiffs' underlying contention is easy to understand, but their conclusion is ultimately false. With the current compensation structure, the more highly leveraged a closed-end fund, the more compensation its advisers receive. A fund's interests may not always be best served by being highly leveraged.[7] Therefore, the plaintiffs conclude, assuming that the funds' advisers are the decision makers—an assumption that has proven incorrect in this case, as will be discussed below—the advisers have a personal monetary incentive to act in a manner that may not be best for the common shareholders of the funds, creating an impermissible conflict of interest.

7. As discussed above, plaintiffs have produced no evidence that, in this case, the funds' objectives actually would have been better served by deleveraging.

This incentive alone, the plaintiffs argue, violates the ICA § 36(b). Under this provision, an investment company's adviser owes the shareholders a fiduciary duty "with respect to the receipt of compensation for services." 15 U.S.C. § 80a-35(b). Two primary issues arise with regard to this contention: first, does the alleged conflict of interest alone violate § 36(b) of the Act, and second, does such a conflict exist in this case. The district court answered both questions in the negative.

Congress enacted the ICA in 1940 to provide a comprehensive federal program to address mismanagement and abuse of investment companies that had become prevalent in the depression era. William P. Rogers and James N. Benedict, *Money Market Fund Management Fees: How Much is Too Much?*, 57 NYU L. Rev. 1059 (Dec. 1982). Because Congress recognized the potential for a fund's adviser to self-deal under a compensation scheme based on a percentage of fund assets, it mandated that forty percent of a fund's board of directors be unaffiliated with the fund's adviser. *Id.*; 15 U.S.C. § 80a-10(a). These independent directors were directly accountable to shareholders and were, among other duties, responsible for determining adviser compensation and approving, by majority, all agreements with advisers. 15 U.S.C. § 80a-15(c). In 1970, recognizing that the potential for abuse called for greater and more easily enforced protection for investors, Congress amended the Act. *Green v. Fund Asset Management, L.P.*, No. 01-2736, 2002 WL 596827 (3d Cir. Apr. 18, 2002). The ICA, as amended, included § 36(b) which created a statutorily imposed fiduciary duty upon advisers regarding their compensation.

Plaintiffs argue that this provision prohibits a closed-end fund's adviser from receiving fees that are based upon a percentage of the fund's assets because the inherent conflict of interest in such an arrangement breaches its fiduciary duty. Nuveen had a duty, they contend, to avoid a fee structure that creates an incentive to consider its own interests when making leverage decisions for the funds. We disagree. First, while an abuse of this inherent conflict may violate § 36(b), its mere existence does not. This holding comports with congressional intent as well as the case law that has developed interpreting the Act. Second, the evidence shows that Nuveen did not have the authority to make final leveraging decisions for the funds.

Although § 36(b) does not explain the term "fiduciary duty," the legislative history surrounding the ICA's 1970 amendment makes clear that the enactment of the provision was not "intended to provide a basis . . . to undertake a general revision of the practices or structures of the investment company industry." H.R. Rep. No. 91-1382 (1970). Congress was well aware, when it amended the Act, that the most common investment company adviser compensation scheme was based on a percentage of assets. "[Advisers'] fees are usually calculated at a percentage of the funds' net assets and fluctuate with the value of the funds' portfolio." S. Rep. No. 91-184 (1969). The very awareness of this structure, and the potential for abuse carried with it by creating various monetary incentives for advisers, prompted Congress to impose a fiduciary duty. By passing § 36(b), it attempted to diminish the risk of adviser self-dealing under the predominant industry practice, not to fundamentally revise the system itself. *See Fund Asset Mgmt.,*

*L.P.*, 2002 WL 596827 at *2. Moreover, Congress has amended the Act, including § 36(b), several times, never indicating that the fee structure as applied to leveraged, closed-end funds was impermissible. The existence of a compensation scheme that could create an incentive for advisers to keep an investment fund leveraged to an extent that may not be best for the fund's common shareholders does not, by itself, create a breach of fiduciary duty under ICA § 36(b).[8] Congress enacted § 36(b)

8. We note that although two of our sister circuits have held that § 36(b) is limited to allegations of excessive fees relative to services provided, *Migdal v. Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321 (4th Cir. 2001); *Gartenberg v. Merrill Lynch Asset Mgmt.*, 694 F.2d 923 (2d Cir. 1982), we, like the Third Circuit, *see Green v. Fund Asset Mgmt.*, 2002 WL 596827, view the provision slightly more broadly. For example, in the improbable case that: 1) the adviser to a closed-end, equity-leveraged fund with an asset-based compensation scheme received additional fees by increasing or maintaining leverage when it predicted that short-term interest rates would exceed long-term rates for a protracted period of time, causing the common shareholders to lose current income; and 2) the adviser, not the board of directors, made final leveraging decisions, a common shareholder's § 36(b) claim might survive summary judgment.

Even in that case, it is important to remember, the receipt of fees and the compensation structure, not the leveraging decision, would be at issue, and damages would be limited to the amount of compensation received. 15 U.S.C. § 80a-35(b); *see also, e.g., In re Nuveen Fund Litig.*, 1996 WL 328006 (June 11, 1996) ("While § 36(b) may regulate more than the mere terms of the fee arrangement between the investment adviser and the investment company, the court does not believe that it regulates the propriety of the transactions for which fees are paid. Rather, § 36(b) only imposes a direct fiduciary duty on the investment adviser with 'respect to the receipt of compensation or payment for services.' "). Because the question raised by the hypothetical case above is not before us today, however, we decline to address the merits of the issue.

to provide a narrow federal remedy that "is significantly more circumscribed than common law fiduciary duty doctrines. . . ." *Id.* at *2. For example, a shareholder may sue only the recipient of the fees in question and has the burden of proving the breach of duty; recovery is limited to actual damages; and damages are recoverable only for the one-year period before the filing of the action. 15 U.S.C. § 80b. Although the existence of a potential conflict like the one plaintiffs assert may create a valid breach of fiduciary duty claim under the common law standard—a question we do not entertain—it does not violate ICA § 36(b).

Moreover, § 205 of the Investment Advisers Act ("IAA"), a companion statute to the ICA, expressly approves of investment compensation contracts which, like this one, are "based upon the total value of a fund over a definite period." 15 U.S.C. § 80b-5. The plaintiffs argue that in 1970, closed-end, tax-exempt leveraged funds like the ones in question did not exist so the IAA's sanction of asset-based compensation does not apply. Shareholders of funds with investment advisers subject to the IAA, they contend, are free to switch advisers and to make his or her own decision to borrow money to buy stock. This argument must fail. The IAA clearly applies to advisers such as Nuveen. *See Zinn v. Parrish*, 644 F.2d 360, 364 (7th Cir. 1981) (IAA covers any entity that receives compensation for giving investment advice.) Congress has amended the IAA several times since the appearance of funds like Nuveen's, and has not limited or shown any intent to restrict the application of § 205.

The plaintiffs in this case produce no evidence showing that Nuveen actually abused its position, thus breaching its

§ 36(b) fiduciary duty. Although they attempt in a secondary argument to show an actual conflict resulting from a leveraging decision in 1994, this time period was before they were shareholders, and before the Act's recoverable one-year period began. This contention, therefore, carries no weight. Moreover, even if these procedural bars were ignored, plaintiffs fail to show that an actual conflict existed. They assert that the advisers received compensation in breach of their fiduciary duty by maintaining preferred-share leverage to increase their fees, resulting in a decrease in portfolio value. They do not dispute, however, that any loss was unrealized, offset by leveraged-enhanced gains the following year, that they would have sacrificed additional income had the funds been deleveraged, that even in the year they reference, the funds outperformed taxable bond funds that did reduce leverage, and that the funds' prospectuses adequately informed them that the funds use leverage which creates increased volatility in portfolio value. The funds each have a secondary objective of enhancing portfolio value through investing in underrated or undervalued municipal bonds, not through leverage decisions. Moreover, the plaintiffs fail to show that Nuveen predicted the interest rate changes when the funds decided to maintain leverage in 1994; therefore, its argument that the advisers made a decision that negatively impacted the common shareholders in order to increase compensation must fail. If the plaintiffs' real complaint is that the advisers (or the directors) made such poor leveraging decisions that a loss to common shareholders resulted, they need to seek recourse "under other sections of the ICA, or alternatively under state law." *Migdal*, 248 F.3d

at 328.[9] Plaintiffs alleged an ICA § 36(a) violation which the district court dismissed for failure to bring derivatively. The have neither appealed that ruling nor attempted to bring a derivative action.

Throughout this litigation, the plaintiffs have maintained that if the advisers controlled the use of leverage, the fee structure itself would violate ICA § 36(b) because of the impermissible incentive it creates. Even if we agreed with this contention, the undisputed facts show that it was *not* Nuveen who controlled the use of leverage, but the funds' directors. The allegedly improper incentive, therefore, is minimal. The plaintiffs do not dispute the fact that the board of directors, the majority of whom were unaffiliated with Nuveen, had ultimate control over the extent of the funds' leverage; they contend only that the directors relied on Nuveen's recommendations. Assuming that this is true, however, it remains undisputed that Nuveen did not have the authority to increase or decrease leverage—that power lay only with the independent board of directors. Summary judgment was appropriate based on this reason alone.

Finally, for each applicable year, the disinterested directors for each of the funds approved the advisory compensation agreements at issue. Because Congress expressly ordered that we give board of director approval

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9. ICA § 36(a) creates a fiduciary duty involving directors' or advisers' personal misconduct. It is unclear whether individual shareholders have an implied right of action under § 36(a) to bring a derivative suit. *Boland v. Engle*, 113 F.3d 706 (7th Cir. 1997). We do not suggest that they do or do not; we merely state that fund mismanagement issues are within the purview of § 36(a), not § 36(b).

"such consideration . . . as is deemed appropriate under all the circumstances," 15 U.S.C. § 80a-35(b)(2), we find that this factor, too, supports the district court's summary judgment ruling.

For the reasons stated herein, we AFFIRM the decision of the district court.

A true Copy:

Teste:

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*Clerk of the United States Court of Appeals for the Seventh Circuit*

*Appendix A*

**UNITED STATES COURT OF APPEALS**
For the Seventh Circuit

Chicago, Illinois 60604

**JUDGMENT - WITH ORAL ARGUMENT**

**Date: July 8, 2002**

**BEFORE:**

Honorable JOEL M. FLAUM, Circuit Judge

Honorable WILLIAM J. BAUER, Circuit Judge

Honorable KENNETH F. RIPPLE, Circuit Judge

No. 01-3671

JACK GREEN, individually and as trustee,
STANLEY SIMON, Trustee, and NORMA EVANS,

Plaintiffs - Appellants,

v.

NUVEEN ADVISORY CORPORATION,

Defendant - Appellee.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 97 C 5255, Ronald A. Guzman, Judge.

The judgment of the District Court is AFFIRMED, with costs, in accordance with the decision of this court entered on this date.

**APPENDIX B — MEMORANDUM OPINION AND ORDER, AND JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION DATED SEPTEMBER 6, 2001 AND FILED SEPTEMBER 10, 2001**

**IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION**

**97 C 5255**

**Judge Ronald A. Guzmán**

**JACK GREEN, individually and as trustee, STANLEY SIMON trustee, and NORMA EVANS,**

**Plaintiffs,**

**v.**

**NUVEEN ADVISORY CORP., JOHN NUVEEN AND CO, INC., RICHARD J. FRANKE, DONALD E. SVEEN, NUVEEN MASSACHUSETTS PREMIUM INCOME MUNICIPAL FUND, NUVEEN INSURED MUNICIPAL OPPORTUNITY FUND, INC., NUVEEN INSURED PREMIUM INCOME MUNICIPAL FUND, INC., NUVEEN PREMIUM INCOME MUNICIPAL FUND 2, INC., NUVEEN INSURED PREMIUM**

*Appendix B*

**INCOME MUNICIPAL FUND 2, NUVEEN PREMIUM INCOME MUNICIPAL 4, INC.,**

**Defendants.**

## MEMORANDUM OPINION AND ORDER

Plaintiffs Jack Green, individually and as trustee, Stanley Simon, trustee, and Norma Evans (collectively "plaintiffs") sued defendants pursuant to Section 36(b) of the Investment Company Act of 1940 ("ICA"), as amended, 15 U.S.C. § 80a-35(b). Before the Court are cross-motions for summary judgment. Defendant Nuveen Advisory Corporation ("Nuveen"), the sole remaining defendant in this case, has moved for summary judgment and plaintiffs have moved for partial summary judgment on the issue of liability. For the following reasons, Nuveen's motion is granted and plaintiffs' motion is denied. This Court has jurisdiction over the matter pursuant to 28 U.S.C. § 1331 and 15 U.S.C. §§ 80a-35(b), 43.

## FACTUAL AND PROCEDURAL BACKGROUND

All recitations of fact are undisputed unless otherwise noted. Plaintiffs own common shares in six closed-end, leveraged, tax-exempt municipal bond funds (collectively "the Funds"). At all times relevant to the current matter, Nuveen has served as the investment advisor of each of the Funds. The primary investment objective of each of the Funds is to provide current income exempt from Federal income tax (and Massachusetts personal income tax for one Fund),

consistent with the Funds' investment policies, through investment in a professionally managed portfolio of tax-exempt municipal obligations.[1] The Funds' secondary investment objective is to enhance the portfolio value relative to the municipal bond market through investments in tax-exempt municipal obligations. The Funds are designed to use leverage to enhance the income produced for common shareholders.[2]

As the investment adviser to each of the Funds, Nuveen received compensation for the services it provided. Nuveen acts as the investment adviser to each of the Funds and manages the investment and reinvestment of each of the Fund's assets. Nuveen also administers the Funds' business affairs, provides office facilities and equipment, and provides clerical, bookkeeping and administrative services. The compensation that Nuveen receives for acting as the investment adviser to the Funds is computed at an annual rate based on a percentage of the daily net assets of the Funds, including the value of assets attributable to the preferred shares outstanding. The "net assets" of the Funds includes any assets attributable to the Funds' leverage. Nuveen does not charge the Funds any administrative fees, service fees, or any fees or charges over and above this advisory fee.

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1. Plaintiffs dispute this apparently because the wording of each of the Funds varies slightly. Although the wording of the primary objectives varies slightly from Fund to Fund, the substantive objective is the same.

2. Generally, leverage is designed to take advantage of the fact that long-term interest rates are typically higher than short-term interest rates.

*Appendix B*

Throughout the time period relevant to this action, each of the Funds had a Board of Directors. A majority of each of the Board of Directors consisted of independent (or "disinterested") directors as required and defined under Section 20 of the ICA, 15 U.S.C. § 80a-10. The Board of Directors for each of the Funds met on a regular basis, at least four times a year, to monitor the performance of the Funds and the activities of Nuveen. The independent directors for each of the Funds met on an annual basis to consider the proposed investment advisory compensation agreement between Nuveen and the respective Fund. In every year relevant to this action, the independent directors for each of the Funds approved the investment advisory compensation agreement between Nuveen and the respective Fund. The directors also controlled the extent of the Funds' leveraging and decisions on whether to leverage or deleverage a Fund.[3]

As of December 31, 1999, there were 202 closed-end, leveraged, tax-exempt municipal bond funds in the industry registered with the Securities Exchange Commission ("SEC"). All 202 of these funds use preferred shares to create leverage. All 202 of these funds paid an advisory fee to their respective investment advisor computed on the basis of net assets or total assets under management. Pursuant to all 202 of these advisor compensation agreements, the value of the

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3. Plaintiffs dispute this statement to the extent that Margaret K. Rosenheim, who had served as a director for one of the Funds, could not recall whether the question of whether to leverage or deleverage a Fund had ever been put to her. (Rosenheim Dep. at 23-24.) Ms. Rosenheim also testified, however, that it was her understanding that the Board of Directors had the authority to leverage or deleverage a Fund. (*Id.* at 23.)

preferred shares is included in the base on which adviser compensation is measured.

Plaintiffs filed their Complaint on June 21, 1996 in the United States District Court for the District of Massachusetts. In addition to Nuveen, plaintiffs named the Funds and several individuals as defendants. This matter was transferred to the Northern District of Illinois by an Order of the United States District Court for the District of Massachusetts pursuant to 28 U.S.C. § 1404(a). Thereafter, defendants filed a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). Defendants' motion was granted in part and denied in part. *Green v. Nuveen Advisory Corp.*, 186 F.R.D. 486, 493 (N.D. Ill. 1999). In an opinion dated March 30, 1999, Judge Bucklo dismissed all but one of plaintiffs' claims (Count III of the Complaint) and dismissed all of the other defendants except for Nuveen. Count III of the Complaint was brought pursuant to Section 36(b) the ICA. Count III alleges that Nuveen has received compensation from the Funds in the face of a conflict between their interests and the Funds' interests amounting to a per se breach of the fiduciary duty imposed under Section 36(b) of the ICA. Plaintiffs argue that having a fee structure that compensates Nuveen according to the net assets (including assets attributable to the Funds' leverage) creates an impermissible incentive to keep the Funds fully leveraged at all times, even when the Funds' investment objectives would not be served by full leverage. Nuveen has now moved for summary judgment on plaintiffs' remaining claim brought under Section 36(b) of the ICA. Plaintiffs have filed a cross-motion for summary judgment as to liability. To achieve leverage, the Funds issued two classes of stock; common shares (which plaintiffs purchased) and preferred shares (the

vehicle for leveraging the common shares). The proceeds from the preferred stock offering were invested at long-term rates, while the preferred dividends were based on short-term rates. Each Fund created leverage by issuing preferred shares in an amount approximately equal to 35% of the Funds' assets after the issuance of the preferred shares.

## DISCUSSION

Traditional standards for summary judgment still apply even where both parties have moved for summary judgment. *American Broad. Co. v. Maljack Prods., Inc.*, 34 F. Supp. 2d 665, 669 (N.D. Ill. 1998). Summary judgment is appropriate where there are no genuine issues of material fact and where the moving party is entitled to judgment as a matter of law. *Liu v. T & H Mach., Inc.*, 191 F.3d 790, 794 (7th Cir. 1999); Fed. R. Civ. P. 56(c). The court should view the record and all reasonable inferences to be drawn from it in the light most favorable to the non-moving party. *Id.* The non-moving party may not rest solely upon the allegations set forth in the pleadings, but must come forward with specific facts sufficient to raise a genuine issue for trial. *Liu*, 191 F.3d at 794-95. When the parties have filed cross-motions for summary judgment, the court looks to the burden of proof that each party would bear on an issue of trial. *Santaella v. Metro. Life Ins. Co.*, 123 F.3d 456, 461 (7th Cir. 1997). Each party is required to go beyond the pleadings and affirmatively establish a genuine issue of material fact. *Id.*

Plaintiffs' argument essentially boils down to two contentions: 1) Nuveen failed to disclose sufficient information to the Board of Directors so that the Board could

evaluate any decision with respect to the maintenance of leverage and thereby breached the fiduciary duty set forth in Section 36(b) of the ICA, and 2) the fee arrangement at issue in this case constitutes a per se breach of the fiduciary duty set forth in section 36(b) of the ICA. Section 36(b) of the ICA establishes a fiduciary duty of investment company advisors to investment company shareholders with respect to determining and receiving their advisory fees. Plaintiffs argue that having a fee structure that compensates Nuveen according to the net assets (including assets attributable to the Funds' leverage) creates an incentive to keep the Funds fully leveraged at all times, even when the Funds' investment objectives would not be served by full leverage. For claims brought under Section 36(b) of the ICA, "the plaintiff shall have the burden of proving a breach of fiduciary duty." 15 U.S.C. § 80a-35(b)(1).

## I. Plaintiffs' disclosure-related claims are not properly before the Court as they were dismissed.

Plaintiffs' first contention can be dealt with relatively briefly. In their pleadings filed in support of their Motion for Summary Judgment, plaintiffs argue that Nuveen breached its fiduciary duty by failing to adequately disclose to the Funds' investors and directors that the compensation agreements at issue involved a conflict of interest between the interests of the investors and Nuveen's interests. (Pls.' Mem. at 19.) However, there is no claim pending before this Court alleging that Nuveen breached its fiduciary duty under Section 36(b) by failing to disclose sufficient information. The only claim before the Court is Count III of the Complaint. All of the other claims, including claims

alleging that Nuveen failed to disclose sufficient information in violation of Section 36(b), were dismissed by Judge Bucklo on March 30, 1999. *Green v. Nuveen Advisory Corp.*, 186 F.R.D. 486 (N.D. Ill. 1999). Count III alleges that Nuveen violated its fiduciary duty under Section 36(b) of the ICA by entering into investment advisory agreements that created a conflict of interest between the interest of the Funds and Nuveen's. (Compl.¶ 85.) Even read in the light most favorable to plaintiffs, Count III does not contain any allegations that Nuveen failed to disclose information in violation of its fiduciary duty under Section 36(b).

Plaintiffs first argue that the Court should consider the merits of the disclosure-related arguments they have raised in their Motion for Partial Summary Judgment because those arguments are not "new theories" and because Nuveen had notice of disclosure-related claims. (Pls.' Reply at 11.) Plaintiffs argue that these disclosure-related claims are not "new theories" because disclosure-related claims were included in their original complaint. (*Id.*) Plaintiffs' arguments must fail, however, because any and all of their disclosure-related claims were dismissed without prejudice by Judge Bucklo on March 30, 1999. *Green v. Nuveen Advisory Corp.*, 186 F.R.D. 486, 493 (N.D. Ill. 1999). If plaintiffs wanted to reassert the disclosure-related claims dismissed by Judge Bucklo over two years ago, plaintiffs had ample opportunity to amend their complaint in the hopes of stating a disclosure-related claim that would withstand a motion to dismiss under Rule 12(b)(6). Plaintiffs' belated attempt to revisit already-dismissed disclosure-related claims for the first time in their Motion for Summary Judgment is an attempt to raise a "new theory" of which Nuveen had no notice. Nuveen simply could not have had notice that plaintiffs were going to attempt to resurrect their

dismissed disclosure-related claims. Plaintiffs' disclosure-related claims are, in fact, "new theories" as they are not to be found in any claim that is currently before the Court.

Plaintiffs next argue that, even if they are asserting a "new theory," this Court should treat the inclusion of disclosure-related arguments in their Motion for Partial Summary Judgment as a request to amend their Complaint to include the disclosure-related claims. (Pls.' Reply at 12.) Plaintiffs cite several cases outside of the Seventh Circuit to support this contention. *See, e.g., In re Bennett Funding Group, Inc.*, 220 B.R. 743, 752 (Bankr. N.D.N.Y. 1997). However, plaintiffs fail to address clear precedent within the Seventh Circuit establishing that, on a motion for summary judgment, it "is too late in the day to be adding new claims." *Auston v. Schubnell*, 116 F.3d 251, 255 (7th Cir. 1997); *Greisz v. Household Bank*, 8 F. Supp. 2d 1031, 1041-42 (N.D. Ill. 1998) (refusing to consider new allegations for the first time at the summary judgment stage); *Teall v. City of Chicago*, 986 F. Supp. 1098, 1101 (N.D. Ill. 1997) (holding that a new claim raised on a motion for summary judgment is "not properly before th[e] court" and refusing to consider that claim). This Court is bound to follow Seventh Circuit precedent. Plaintiffs have failed to cite any Seventh Circuit precedent supporting their argument that this Court should consider these new claims raised at the summary judgment stage. Any and all of plaintiffs' disclosure-related claims that were dismissed by Judge Bucklo in her March 30, 1999 decision are not properly before the Court, and plaintiffs cannot resuscitate those claims at this late stage. Claims not included in Count III of the Complaint (the only surviving Count) shall not be considered by this Court in the parties' cross-motions for summary judgment.

**II. The compensation agreement at issue does not constitute a per se breach of the fiduciary duty imposed by Section 36(b) of the ICA.**

Plaintiffs' second contention, that the fee arrangement entered into by Nuveen constituted a per se breach of the fiduciary duty in Section 36(b), requires more time and space to address. The parties spend considerable time and space arguing over whether a claim for breach of the fiduciary duty under Section 36(b) is limited to a claim for excessive fees. At least two courts have held that a claim under Section 36(b) is limited to claims of excessive fees. *See Migdal v. Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 327 (4th Cir. 2001); *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 928 (2nd Cir. 1982). Relying on *Green v. Fund Asset Management, L.P.*, 19 F. Supp. 2d 227, 234-35 (D.N.J. 1998),[4] this Court took a broader view of Section 36(b) and allowed plaintiffs to pursue a claim alleging that the compensation agreement in questions created a conflict of interest in violation of the fiduciary duty contained in Section 36(b). *See Green v. Nuveen Advisory Corp.*, 186 F.R.D. 486, 491 (N.D. Ill. 1999). Plaintiffs argue that this Court should employ a broad, common law fiduciary standard[5] while Nuveen argues that this Court

4. One of the plaintiffs in the instant case, Jack Green, was also a plaintiff in *Green v. Fund Asset Management, L.P.* In order to avoid confusion, that case shall hereinafter be cited as "*Fund Asset Management, L.P.*"

5. Plaintiffs rely on Second Circuit precedent in support of their contention "that investment advisors' conduct [should] be governed by traditional common law standards of fiduciary responsibility." (Cont'd)

should limit Section 36(b) to claims for excessive fees. This Court already addressed the extent that it will consider a breach of fiduciary claim under Section 36(b) when it allowed plaintiffs to proceed with a claim under Section 36(b) alleging that the compensation agreement entered into created a conflict of interest breaching a fiduciary duty in violation of Section 36(b). This Court need not revisit the issue here and will limit its consideration to the conflict of interest theory which survived Nuveen's motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6).

The Court begins by noting that only one other court has addressed a claim similar to the one advanced by plaintiffs in the current matter. *See Green v. Fund Asset Mgmt, L.P.*, 147 F. Supp. 2d 318 (D.N.J. 2001) (hereinafter *Fund Asset Management, L.P. II*). The facts in *Fund Asset Management, L.P. II* are virtually identical and so are many of the legal issues raised therein. In *Fund Asset Management, L.P. II*, the court granted summary judgment in favor of the defendants on these same issues because (among other reasons): 1) it is highly unlikely that, through Section 36(b), Congress intended to make illegal the predominant advisory compensation fee arrangement; and 2) the board of directors

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(Cont'd)

(Pls.' Mem. Supp. Mot. Summ. J. at 8) (citing *Galfand v. Chestnutt Corp.*, 545 F.2d 807, 811 (2nd Cir. 1976)). Second Circuit precedent is not so clear on this issue. *See, e.g., Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 928 (2nd Cir. 1982) (holding that "[t]o be guilty of a violation of § 36(b), therefore, the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining.").

of the funds had considered, reconsidered and approved the advisory compensation arrangements. *Id.* at 331-32. This Court finds the District Court of New Jersey's treatment of these two issues in *Fund Asset Management, L.P. II* persuasive and adopts that court's reasoning in the instant case. In addition to the reasons set forth in *Fund Asset Management, L.P. II*, this Court also grants summary judgment in favor of Nuveen because the ICA's companion statute, the Investment Advisers Act, 15 U.S.C. § 80b-5, expressly approves of the fee arrangement at issue in the current case and because the Board of Directors of each of the Funds made the leverage decisions, *not* Nuveen, rendering any potential conflict of interest minimal at best.

**A. Congress did not intend to invalidate the fee structure used by every single closed-end, leveraged tax-exempt municipal bond fund.**

Plaintiffs do not dispute that "[a]ll 202 of the closed-end, leveraged tax-exempt municipal bond funds in the industry registered with the SEC (as of December 31, 1999) pay an advisory fee computed on the basis of net assets or total assets under management." (Def.'s LR 56.1(a)(3) ¶ 76; Pls.' LR 56.1(b)(3)(A) ¶ 76.) If this Court were to hold that the fee arrangement in this case were a per se breach of the fiduciary duty under Section 36(b) of the ICA, then literally all of the advisory compensation agreements utilized by the 202 closed-end, leveraged, tax exempt municipal bonds would also be invalid under Section 36(b) of the ICA. As the only other court to address this issue held, "[s]urely Congress did not intend this absurd result." *Fund Asset Mgmt. L.P. II*, 147 F. Supp. 2d at 331. This Court is extremely reluctant to

find that through the fiduciary duty requirement in Section 36(b), Congress implicitly intended to invalidate all of the fee arrangements utilized by all of the closed-end, leveraged, tax-exempt municipal bond funds in the industry.

Relying primarily on *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 929 (2nd Cir. 1982), plaintiffs argue that industry practice is irrelevant for determining whether a fee arrangement is a per se breach of fiduciary duty under Section 36(b) of the Act. (Pls.' Opp'n at 21.) Plaintiffs also maintain that industry practice is irrelevant because "Nuveen has failed to present any evidence of any factual justification for its compensation arrangement,[6] nor can any be inferred from other municipal bond fund advisors making the same improper choice." (Pls.' Mem. Supp. Mot. Partial Summ. J. at 14.) Both of these arguments fail.

Plaintiffs' reliance on *Gartenberg* is misplaced because that court held that reliance on prevailing industry advisory fees is not sufficient to establish that the fees are not excessive. *Id.*, 694 F.2d at 929. Plaintiffs in the instant case do not allege that Nuveen received excessive fees in violation of Section 36(b), rather plaintiffs allege that the fee arrangement in question is a per se violation of the fiduciary duty imposed under Section 36(b). Plaintiffs' argument that

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6. Plaintiffs erroneously assume that it is Nuveen's burden to prove that the fee arrangement is *not* a violation of the fiduciary duty imposed by Section 36(b) of the ICA. This is clearly not the case. The ICA expressly provides that "the plaintiff shall have the burden of proving a breach of fiduciary duty." 15 U.S.C. § 80a-35(b)(1).

the propriety of the fee arrangement in question cannot be inferred from the fact that it is widely used in the industry also fails. This Court is not looking at industry practice in order to determine whether the fees charged by Nuveen are excessive or improper. Rather, this Court is looking at industry practice as a way of illustrating the absurdities that would result if the Court were to declare the fee arrangement at issue in the current matter invalid under Section 36(b) of the ICA.

**B. The fact that the Boards of Directors of the respective Funds approved the fee arrangements in question militates against finding that the fee structure is invalid.**

In an action alleging breach of fiduciary duty brought under Section 36(b) of the ICA, the approval of an advisory compensation arrangement by the board of directors of an investment company "shall be given such consideration by the court as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2). Plaintiffs do not dispute that "[i]n every year relevant to this action, the independent directors for each of the Funds approved the investment advisory agreement between each respective Fund and Nuveen Advisory." (Def.'s LR 56.1(a)(3) ¶ 115; Pls.' LR 56.1(b)(3)(A) ¶ 115.) Like the court in *Fund Asset Management II*, this Court holds that "such undisputed approval militates strongly against the contention that the advisors have breached their fiduciary duty to the funds or their shareholders." *Fund Asset Mgmt. II*, 147 F. Supp. 2d at 332.

*Appendix B*

**C. Congress' approval of the type of compensation agreement at issue in the current matter in the IAA is persuasive evidence that Congress did not intend to invalidate that same compensation agreement in the ICA.**

Congress' express recognition of the validity of advisory compensation contracts which compensate the advisor "based upon the total value of a fund over a definite period," 15 U.S.C. § 80b-5, strongly suggests that the compensation agreement at issue is valid and proper. Congress has expressly prohibited certain investment advisory compensation contracts in the Investment Advisers Act ("IAA"). 15 U.S.C. § 80b-5. In doing so, Congress specifically exempted from prohibition any "investment advisory contract which provides for compensation based upon the total value of a fund over a definite period." *Id.* The Supreme Court has referred to the ICA and the IAA as "companion" statutes. *Burks v. Lasker*, 441 U.S. 471, 480 n. 8 (1979). When interpreting statutes dealing with a related subject, it is proper to consider the two statutes together. *Linquist v. Bowen*, 813 F.2d 884, 888-89 (8th Cir. 1987) (citations omitted); *see also In re Johnson*, 787 F.2d 1179, 1181 (7th Cir. 1986) (per curiam) (explaining that "a specific statute takes precedence over a more general statute"). In light of these general rules of statutory interpretation, this Court holds that Congress' express approval of investment advisory contracts which provide for compensation based upon the total value of a fund over a definite period in the IAA is persuasive evidence that Congress did not intend to invalidate those same compensation arrangements in the IAA's companion statute, the ICA.

*Appendix B*

It is undisputed that "[t]he Funds do not employ a performance based fee structure prohibited under § 205 of the [IAA, 15 U.S.C. § 80b-5]" and that "Nuveen Advisory's fees are based upon the total value of the Funds over a definite period, not solely on a share of capital gains or capital appreciation." (Def.'s LR 56.1(a)(3) ¶ 59; Pls.' LR 56.1(b)(3)(A) ¶ 59.) The IAA's approval of the type of advisory compensation contracts at issue in the current matter strongly militates against a determination that these compensation agreement constitute a per se breach of the fiduciary duty imposed under Section 36(b) of the ICA.[7]

**D. The Boards of Directors of the respective Funds, not Nuveen, made the leverage decisions thereby making any conflict of interest between Nuveen and the Funds minimal.**

Finally, plaintiffs have failed to produce any evidence establishing that Nuveen controlled the extent of the Funds' leveraging or decisions on whether to leverage the Funds. Since Nuveen did not control the extent of the Funds' leveraging, any conflict of interest between the interests of the funds and shareholders and Nuveen's interests arising out of the compensation arrangement at issue in the current matter is minimal at best. In light of the undisputed fact that Nuveen does not control the extent of leverage of the Funds, this Court holds that any potential conflict of interest arising out of the compensation agreement is insufficient to establish a breach of the fiduciary duty imposed by Congress in Section 36(b) of the

7. Plaintiffs fail to respond to these arguments in their Memorandum in Opposition to Defendant's Motion for Summary Judgment.

ICA. *Cf. Friend v. Sanwa Bank Cal.*, 35 F.3d 466, 469 (9th Cir. 1994) (holding that, under Section 404(a)(1)(A)(i) of ERISA, a fiduciary bank "does not commit a per se violation of section 1104(a)(1) by the mere act of becoming a trustee with conflicting interests.").

Plaintiffs do not dispute that "[t]hroughout the time period relevant to this action, a majority of the Board of Directors for each of the Funds consisted of independent (or 'disinterested') directors, as required and defined under Section 20 of the [ICA], 15 U.S.C. § 80a-10." (Def.'s LR 56.1(a)(3) ¶ 102; Pls.' LR 56.1(b)(3)(B) ¶ 102.) Plaintiffs also do not dispute that "[t]he directors controlled the extent of the Funds' leveraging and decisions on whether to leverage or deleverage a Fund." (Def.'s LR 56.1(a)(3) ¶ 110; Pls.' LR 56.1(b)(3)(B) ¶ 110.)

Although plaintiffs do not dispute these facts, they do argue that "[d]iscovery has shown, however, that most or many of [the independent directors] are cronies of Nuveen."[8] (Pls.' LR

8. It is not even clear that an allegation of "cronyism" is supported by the record. To support this argument, plaintiffs cite the deposition testimony of Thomas C. Spalding. Mr. Spalding testified that some of the people who have served as disinterested directors of the funds were acquainted with some of the officers and employees of Nuveen. (Pls.' Ex. 14; Spalding Dep. at 184-87.) Mr. Spalding is then asked if, "[w]ith respect to the disinterested directors of the Nuveen funds generally, is it fair to say . . . that insofar as you understand the genesis or background of their becoming disinterested directors, that it is the case that most, if not all of them, have become disinterested directors in the context of their having had some acquaintance or prior relationship with some person who was an officer or employee of the Nuveen Companies at the time of that person's proposal as a disinterested director?" (*Id.* at 187-88.). Mr. Spalding answered, "I—I can't make that statement." (*Id.* at 188.)

56.1(b)(3)(B) ¶ 102.) This allegation of "cronyism" does not change the fact that plaintiffs do not dispute "that the independent directors fit within the [ICA] definition of 'disinterested.' " (*Id.*) Plaintiffs also contend that "[t]he directors also relied upon [Nuveen] . . . for recommendations as to management of leverage." If plaintiffs are attempting to establish that Nuveen was actually the entity with the power to determine whether to leverage or deleverage a Fund, plaintiffs need more than conclusory allegations of "cronyism" and the fact that the directors relied on Nuveen's recommendations to establish this assertion. *See Liu v. T & H Mach., Inc.*, 191 F.3d 790, 796 (7th Cir. 1999) ("A party must present more than mere speculation or conjecture to defeat a summary judgment motion.") (citations omitted); *Aberman v. J. Abouchar & Sons, Inc.*, 160 F.3d 1148, 1150 (7th Cir. 1998) (holding that in the absence of supporting evidence, conclusory allegations by the party opposing a summary judgment motion cannot defeat the motion) (citations omitted).

Amazingly, plaintiffs do not respond to this argument in their Memorandum in Opposition to Defendant's Motion for Summary Judgment. Plaintiffs are apparently content to rely on the related arguments they raised in their own Motion for Partial Summary Judgment. Unfortunately for plaintiffs, however, the arguments they raised relate to the disclosure-related claims that are not properly before the Court. (Pls.' Mem. Supp. Mot. Summ. J. at 23-26.) Specifically, plaintiffs argue that "Nuveen breached its fiduciary duty by failing to supply information sufficient to enable the Board of Directors to evaluate Nuveen's decisions with respect to the maintenance of leverage." (*Id.* at 23.) Even if any disclosure

related claims were before the Court, this argument would fail because plaintiffs fail to include any facts in their Statement of Material Facts establishing that Nuveen failed to supply information sufficient to enable the Board of Directors to evaluate Nuveen's decisions with respect to the maintenance of leverage.

The closest that plaintiffs come to asserting facts establishing that Nuveen failed to provide sufficient information to the respective Boards of Directors of the Funds is an assertion that "[t]he Board of Directors is wholly dependent upon Nuveen Advisory for financial business recommendations and decisions with respect to leverage." (Pls.' LR 56.1(a)(3) ¶ 44.) However this assertion utterly fails to establish that Nuveen failed to supply information sufficient to enable the Board of Directors to evaluate Nuveen's decisions with respect to the maintenance of leverage. Moreover, Nuveen filed a Statement of Additional Facts in opposition to Plaintiffs' Motion for Partial Summary Judgment pursuant to Local Rule 56.1(b)(3)(B). In its Statement of Additional Facts, Nuveen asserts that "[t]he directors controlled the extent of the Funds' leveraging and decisions to leverage or deleverage a fund" (Def.'s LR 56.1(b)(3)(B) ¶ 259) and that "[t]he directors routinely received and reviewed materials showing the contribution leverage made to current income" (*Id.* ¶ 252). Plaintiffs failed to respond to Defendant's Statement of Additional Facts. "All material facts set forth in the statement filed pursuant to section (b)(3)(B) will be deemed admitted unless controverted by the statement of the moving party." Local Rule 56.1(a). Pursuant to Local Rule 56.1, these assertions are deemed admitted by plaintiffs. Plaintiffs have failed to

produce evidence establishing that Nuveen failed to provide sufficient information to the respective Boards of Directors.

It is undisputed that Nuveen did not control the extent that the Funds were leveraged. It is also undisputed that the respective Boards of Directors controlled the extent that the Funds were leveraged. Plaintiffs have failed to respond directly to these facts and the arguments raised by Nuveen in relation to these facts. This Court holds that any conflict of interest between the interests of the funds and shareholders and Nuveen's interest arising out of the compensation agreement at issue is minimal at best and fails to establish a breach of the fiduciary duty imposed under Section 36(b) of the ICA.

## CONCLUSION

For the reasons stated above, the Court grants the sole remaining defendant Nuveen's Motion for Summary Judgment [doc. no. 129-1] and denies plaintiffs' Motion for Partial Summary Judgment [doc. no. 132-1]. This case is hereby terminated.

**SO ORDERED** 9-6-01

**ENTERED:**

s/ Ronald A. Guzman
**HON. RONALD A. GUZMAN**
**United States Judge**

*Appendix B*

**UNITED STATES DISTRICT COURT**
**Northern District of Illinois**
**Eastern Division**

**JUDGMENT IN A CIVIL CASE**

Case Number: 97 C 5255

Jack Green, et al

v.

Nuveen Advisory Corp.

❒ Jury Verdict. This action came before this Court for a trial by jury. The issues have been tried and the jury rendered its verdict.

■ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS HEREBY ORDERED AND ADJUDGED that the Court grants the sole remaining defendant Nuveen's motion for summary judgment [129-1] and denies plaintiffs' motion for partial summary judgment [132-1]. This case is hereby terminated.

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On March 30, 1999, Counts One, two, four and five were dismissed without prejudice and the motion to dismiss plaintiffs' 36(b) claim under the ICA was granted with respect to all defendants except defendant Nuveen Advisory Corp.

Michael W. Dobbins, Clerk of Court

_____

Theresa B. Kinney, Deputy Clerk

Date: 9/6/2001

**APPENDIX C — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION DATED AND FILED MARCH 30, 1999**

**IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS EASTERN DIVISION**

No. 97 C 5255

**JACK GREEN, INDIVIDUALLY AND AS TRUSTEE, STANLEY SIMON TRUSTEE, AND NORMA EVANS,**

Plaintiffs,

v.

**NUVEEN ADVISORY CORP., JOHN NUVEEN AND CO., INC., RICHARD J. FRANKE, DONALD E. SVEEN, NUVEEN MASSACHUSETTS PREMIUM INCOME MUNICIPAL FUND, NUVEEN INSURED MUNICIPAL OPPORTUNITY FUND, INC., NUVEEN INSURED PREMIUM INCOME MUNICIPAL FUND, INC., NUVEEN PREMIUM INCOME MUNICIPAL FUND 2, INC., NUVEEN INSURED PREMIUM INCOME MUNICIPAL FUND 2, NUVEEN PREMIUM INCOME MUNICIPAL FUND 4, INC.,**

Defendants.

**MEMORANDUM OPINION AND ORDER**

*Appendix C*

Plaintiffs brought this action on behalf of themselves and other common stockholders alleging that the defendants violated sections 8(e), 34(b), 36(a), and 36(b) of the Investment Company Act [the "ICA"], as well as state law. Plaintiffs move for certification of plaintiff and defendant classes. Defendants move to deny class certification and to dismiss the complaint on various grounds. For the following reasons, defendants' motion to dismiss is granted in part and denied in part, and plaintiffs' motion for certification is denied.

*Background*[1]

The plaintiffs are common stockholders in publicly traded, closed-end investment companies that are defendants in this lawsuit. These investment companies, the "Funds," include Nuveen Massachusetts Premium Income Municipal Fund ["Nuveen Massachusetts"], Nuveen Insured Municipal Opportunity Fund, Inc. ["Nuveen Insured"], Nuveen Insured Premium Income Municipal Fund, Inc. ["Nuveen Insured Premium"], Nuveen Premium Income Municipal Fund 2, Inc. ["Nuveen Premium 2"], Nuveen Insured Premium Income Municipal Fund 2 ["Nuveen Insured Premium 2"], and Nuveen Premium Income Municipal Fund 4, Inc. ["Nuveen Premium 4"]. The Funds are registered with the Securities and Exchange Commission. Their principal investment objective is to realize current income exempt from federal income taxation. The Funds increase the yield paid to

1. The background facts are taken from the complaint. When evaluating a motion to dismiss, I must assume that all well-pleaded factual allegations are true. *Prince v. Rescorp Realty*, 940 F.2d 1104, 1106 (7th Cir. 1991).

common stockholders through the use of leverage. The Funds leverage by issuing senior securities in the form of "municipal auction rate cumulative preferred shares" ["APS"]. Such APS are sold through public offerings and pursuant to registration statements and related documents filed with the SEC. The dividend rate on each issue of APS is determined periodically on a fixed, short-term cycle by an auction process. The auction process normally results in a dividend rate on the APS approximately equal to short-term interest rates. In offering and selling the APS, the Funds use the APS to leverage their common stock.

Defendant Nuveen Advisory is the financial adviser for the Funds. Per agreement, on a periodic basis Nuveen Advisory is compensated a percentage of the net assets of the fund for which it serves as investment advisor. The net assets from which the percentage is calculated include all leveraging. The Funds also have agreements with an auction agent for the purpose of auctioning the APS. The auction agent in turn has agreements with broker-dealers, including John Nuveen and Co., Inc. ["John Nuveen"], pursuant to which the broker-dealers receive continuing revenues from the periodic remarketing of the Funds' APS.

Plaintiffs allege that the compensation agreements create a conflict of interest, because the defendants have a strong financial interest in keeping the Funds fully leveraged even if doing so would not be in the best interests of the stockholders. Counts one and two allege that the defendants violated sections 8(e), 34(b) and 36(a) of the ICA. Count three alleges that defendants violated § 36(b) of the ICA. Count four alleges common law deceit, and count five alleges common law breach of fiduciary duty. Plaintiffs ask for damages and a permanent injunction.

## *Appendix C*

### *Motion to Dismiss Counts One and Two*

Sections 8(e), 34(b), and 36(a) of the ICA do not expressly provide for private rights of action, and neither the United States Supreme Court nor the Seventh Circuit has decided whether the ICA creates an implied right of action. Regardless of whether implied rights of action exist under the ICA, however, I agree with the defendants that the claims in counts one and two must be dismissed because they should have been pleaded derivatively. A derivative action permits a shareholder to bring a lawsuit belonging to the corporation against corporate officers and directors, as well as against third parties. *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991). Since all of the Funds that are defendants in this lawsuit are Massachusetts and Minnesota business organizations, Massachusetts and Minnesota law governs whether the plaintiffs' claims are direct or derivative. *See id.* at 108-09 (stating that for claims under the ICA, federal courts should generally look to corporation law of the state where the investment company is incorporated).[2]

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2. Two of the Funds, Nuveen Massachusetts and Nuveen Insured Premium 2 (which has acquired Nuveen Insured Premium), are organized as Massachusetts business trusts rather than corporations. Courts applying Massachusetts law to shareholder suits against business trusts have uniformly required the shareholder to follow Massachusetts law regarding derivative suits. *See, e.g., Clairdale Enters., Inc. v. C.I. Realty Investors*, 423 F. Supp. 257 (S.D.N.Y. 1976) (applying demand requirement to derivative suits involving Massachusetts business trusts); *Jones v. Equitable Life Assurance Soc'y of the United States*, 409 F. Supp. 370 (S.D.N.Y. 1975) (the same); *Greenspun v. Lindley*, 330 N.E.2d 79 (1975) (the same); *see also* 13 Am. Jur. 2d Bus. Trusts § 105 (discussing derivative actions

(Cont'd)

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Under both Massachusetts and Minnesota law, a shareholder may not directly bring claims that belong to the corporation. *Arent v. Distribution Sciences, Inc.*, 975 F.2d 1370, 1372 (8th Cir. 1992); *Bessette v. Bessette*, 434 N.E.2d 206, 208 (Mass. 1982). To determine whether a claim belongs to the corporation, a court must inquire whether the shareholder's injury is distinct from the injury suffered generally by the shareholders as owners of corporate stock. *Arent*, 975 F.2d at 1372, *Jackson v. Stuhlfire*, 547 N.E.2d 1146, 1148 (1990); *see also International Broad. Corp. v. Turner*, 734 F. Supp. 383, 392 (D. Minn. 1990) ( "[w]hether a claim is properly brought as an individual action rather than derivative turns on whether the claimant has suffered an injury distinct from one incurred by the corporation").

Count one of the complaint alleges that the Funds filed false, incomplete, and misleading registration statements and other filings with the SEC, and that Nuveen Advisory, John Nuveen, and the individual defendants aided and abetted the Funds in making such filings. Count two alleges a breach of fiduciary duty by the Funds in filing such statements and in entering into compensation arrangements with Nuveen Advisory that resulted in conflicts of interests between the Funds and other defendants. Count two also alleges that Nuveen Advisory, John Nuveen, and the individual defendants

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(Cont'd)

by shareholders of business trusts). The plaintiffs have not argued that I should distinguish between the corporations and the business trusts for the purposes of determining whether their claims are direct or derivative, and I do not find any reason to do so under Massachusetts law.

aided and abetted the Funds in such actions. Plaintiffs allege that as a result, they have

> suffered damages through their purchase of the common stock of such Funds, the payment by such Funds of compensation to Nuveen Advisory and the resulting conflict of interest to which Nuveen Advisory has been subject in its provision of investment advisory services to such Funds. (Compl. ¶ 79, ¶ 83).

The complaint does not allege that the Funds' payment of the fees and the resulting conflict of interest caused the plaintiffs to suffer an injury distinct from any other common shareholder in the Funds.

The plaintiffs argue that nonetheless, their injury is unique for three reasons. First, plaintiffs argue that other courts have allowed direct actions for claims brought under the ICA. The cases cited by plaintiffs are distinguishable. In *In re ML-Lee Acquisition Fund II, L.P. and ML-Lee Acquisition Fund (Retirement Accounts) II, L.P. Sec. Litig.*, 848 F. Supp. 527 (D. Del. 1994), the court allowed the stockholders to maintain direct claims for violations of securities law. In addition to alleging such violations, however, the plaintiffs alleged "that the Defendants breached the partnership agreement with the individual investor Plaintiffs, and that each independent breach of contract resulted in a direct injury to each individual investor." *Id.* at 562. The plaintiffs also alleged that the defendants created the funds for the purpose of defrauding the plaintiffs. *Id.* In the case at bar, the complaint does not allege that the defendants breached a duty owed to the shareholders directly, as individuals.

*See, e.g., Olesh v. Dreyfus Corp.*, 1995 WL 500491, at *7 (E.D.N.Y. 1995) (noting that a suit is derivative in the absence of a "special relationship" between the shareholder and defendant that creates a duty beyond that owed to the corporation). The plaintiffs also cite *Dowling v. Narragansett Capital Corp.*, 735 F. Supp. 1105 (D.R.I. 1990), in support of their argument. In *Dowling*, the defendants were controlling shareholders, and the court reasoned that if damages were only recoverable by the corporation in a derivative suit, the defendants "would reap much of the benefit from their alleged wrongdoing." *Id.* at 1113. Likewise, in *Langner v. Brown*, 913 F. Supp. 260 (S.D.N.Y. 1996), the plaintiff was a minority shareholder. *Krinsk v. Fund Asset Management Inc.*, 654 F. Supp. 1227 (S.D.N.Y. 1987), is also distinguishable. In *Krinsk*, the fees contested by the plaintiffs were annual service fees paid by all members of an organization, regardless of whether they were shareholders. *Id.* at 1234-35. The fees at issue were "[i]n no respect . . . compensation paid by the Fund for services rendered to the Fund." *Id.* at 1235. In the case at bar, the complaint alleges that the advisory fees were paid by the Fund.

Second, plaintiffs argue that only the common shareholders were injured by the compensation scheme at issue. The complaint, however, does not allege that plaintiffs are minority shareholders. *Strougo v. Scudder, Stevens & Clark, Inc.*, 964 F. Supp. 783 (S.D.N.Y. 1997), cited by plaintiffs, does not support their argument. In *Strougo*, the court discussed numerous cases in which majority or controlling shareholders caused injuries unique to minority shareholders. *Id.* at 792-93. The court then dismissed the plaintiffs' claims, because, unlike the plaintiffs in the cases

which the court had reviewed, the plaintiff in *Strougo* did not allege that he was a "minority shareholder whose ownership interest was diluted disproportionately to that of majority shareholders." *Id.* at 793. The complaint in the case at bar alleges that *all* of the common shareholders sustained the same injuries as a result of the compensation scheme. The existence of preferred shares, standing alone, does not render the common shareholders' injuries distinct from the Funds' injuries.

Third, plaintiffs argue that the value of their investment was diminished regardless of any loss to the Funds. The complaint alleges that the plaintiffs were harmed as common stockholders by the Funds' payment of certain fees to Nuveen Advisory, and by the resulting conflict of interest. Diminution in value of the common stock due to advisory fees paid by the Funds is an injury to the Funds, and any harm to the plaintiffs as common shareholders is derivative in nature. The plaintiffs cannot assert a direct class action claim for such injuries. Counts one and two are accordingly dismissed without prejudice.

*Motion to Dismiss Count III*

Defendants argue that the complaint does not state a claim for relief under § 36(b) of the ICA.[3] According to defendants, the claim is defective because it fails to allege that the fees paid are excessive, because plaintiffs have not suffered damages within one year of filing the complaint, and because Nuveen Advisory is the only defendant that can be held liable.

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3. Defendants acknowledge that a private right of action exists for § 36(b) claims, and that there is not a demand requirement.

## *Appendix C*

### *A) Excessive Fees*

Section 36(b) of the ICA provides in relevant part:

> For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. 15 U.S.C. § 80a-35(b).

The complaint alleges that Nuveen Advisory breached a fiduciary duty with respect to compensation for services. Defendants argue that nonetheless, plaintiffs do not state a claim because they do not allege that the compensation is excessive. Citing *Galfand v. Chestnutt Corp.*, 545 F.2d 807 (2d Cir. 1976), plaintiffs respond that § 36(b) is not expressly limited to excessive fee claims and includes claims based on allegations of inadequate disclosure concerning the nature of a fee agreement. In *Galfand*, the court noted that an investment adviser is under a duty of full disclosure and fairness where a potential conflict of interest exists between the investment adviser's interests and the fund's interests. *Id.* at 811-12. In addition, in a case very similar to the case at bar, a court found that an advisory fee arrangement which bases the adviser's compensation in part on the amount of preferred stock could create a conflict of interest in violation of the fiduciary duty set forth in § 36(b). *Green v. Fund Asset Management, L.P.*, 19 F. Supp. 2d 227, 234-35 (D.N.J. 1998).

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The plain language of § 36(b) does not specify that the breach of fiduciary duty must relate to excessive compensation. Plaintiffs have adequately alleged that the compensation agreements create a conflict of interest breaching a fiduciary duty in violation of § 36(b). Defendants argue that nonetheless, such a compensation scheme is not unusual, and plaintiffs were not injured by the agreement. Determining whether defendants' arguments have merit would require looking beyond the pleadings at market circumstances and other economic factors. It is premature to dismiss the plaintiffs' § 36(b) claim at this time.

*B) Damages Within One Year*

Defendants also argue that plaintiffs' 36(b) claim should be dismissed because the plaintiffs did not suffer damages within one year of the filing of the complaint. Plaintiffs bringing a § 36(b) claim cannot recover damages "for any period prior to one year before their action was instituted." 15 U.S.C. § 80a-35(b)(3). In support of their argument, defendants point to a section of the complaint alleging that when interest rates were increasing between February 1994 and February 1995, the Funds' common stock suffered a greater decline than that which would have resulted if the leverage had been reduced or eliminated. Defendants argue that therefore any potential damages occurred more than one year before the complaint was filed.

Plaintiffs concede that the damages period extends back only one year before the action was filed, but argue that such a limitation provides no basis for dismissal of the claim. I agree. The complaint alleges that as a result of defendants'

acts, plaintiffs have suffered damages. Assuming that the allegations are true, as a result of the defendants' failure to deleverage during the 1994-95 time period the net asset value of the Funds' common stock has suffered a substantially greater decline than otherwise would have resulted. The complaint does not allege that those damages occurred only prior to June 1995. Whether the plaintiffs actually suffered damages within one year prior to the filing of the complaint is a factual question not appropriate for consideration on a motion to dismiss.

*C) Affiliated Persons*

Defendants argue that Nuveen Advisory is the only defendant potentially liable for a § 36(b) violation. Section 36(b) provides in relevant part:

> An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. 15 U.S.C. § 80a-35(b)

However, "[n]o such action shall be brought or maintained against any person other than the recipient of such

compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments." 15 U.S.C. § 80(a)-35(b)(3).

Defendants argue that Nuveen Advisory is the only defendant potentially liable under § 36(b) because it is the only defendant that plaintiffs allege received compensation for advisory services. Plaintiffs respond that the remaining defendants can be held liable because they are affiliated persons or other persons who received payments within the meaning of § 36(b). The complaint alleges that Nuveen Advisory is a wholly owned subsidiary of John Nuveen. An "affiliated person" under § 36(b) includes "any person directly or indirectly controlling . . . such other person. . . ." 15 U.S.C. § 80a-2(a)(3). The complaint does not, however, allege that John Nuveen received compensation for advisory services. Instead, it alleges that John Nuveen received compensation with respect to all shares of APS sold to it or continued to be held by it as a result of a sale in an earlier auction. This compensation is pursuant to an agreement between John Nuveen and an auction agent.

Defendants argue that other courts have held it is outside the language and intent of § 36(b) to hold liable affiliated persons where the complaint does not allege that those persons received compensation for advisory services. In *In re TCW/DW N. Am. Gov't Income Trust Sec. Litig.*, 941 F. Supp. 326, 343 (S.D.N.Y. 1996), the court held that the principal underwriters of an investment advisory firm could not be held liable where the complaint did not allege that those underwriters received compensation for advisory services, although they did receive other fees. A case on which

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*In re TCW* relies, *Halligan v. Standard & Poor's/Intercapital, Inc.*, 434 F. Supp. 1082 (E.D.N.Y. 1977), draws its conclusion from a Senate Report. In the Report, the Senate Committee on Banking and Currency explained that § 36(b) provides a remedy "if the investment adviser should try to evade liability by arranging for payments to be made not to the adviser itself but to an affiliated person of the adviser." S. Rep. No. 91-184 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4897.

Count three alleges that Nuveen Advisory breached a fiduciary duty by entering into compensation agreements for its advisory services that create a conflict of interest, and that John Nuveen is liable as an affiliated person of Nuveen Advisory. The complaint also alleges that John Nuveen received compensation with respect to all shares of APS sold to it by a broker-dealer, or held by it as a result of a sale in an earlier auction. (Compl. ¶ 35). The complaint does not, however, allege that John Nuveen received payments from the Funds or its shareholders, or that Nuveen Advisory arranged for compensation to be paid to John Nuveen. Section 36(b) provides a remedy for breach of fiduciary duty with respect to payments made by the investment company or its security holders. 15 U.S.C. § 80a-35(b). Although John Nuveen is an affiliated person, I agree with defendants that the service fees it receives are not payments of a material nature within the meaning of § 36(b). Therefore John Nuveen cannot be held liable under § 36(b).

Defendants also argue that the named, individual defendants cannot be held liable under § 36(b). The individual defendants in this case, Richard J. Franke and Donald E. Sveen, are directors of Nuveen Advisory as well as the Funds.

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An action under § 36(b) may be brought against affiliated persons of the investment adviser. 15 U.S.C. § 80(a)-35(b). Affiliated persons include directors. 15 U.S.C. § 80a-2(a)(3). The complaint, however, does not allege that the individual defendants received compensation for services or other payments of a material nature by the Funds or their shareholders, as is required for liability under § 36(b). Therefore defendants' motion to dismiss count three is granted as to John Nuveen and individual defendants, and is denied as to Nuveen Advisory.

*Motion to Dismiss Count Four and Five*

Counts four and five allege common law claims of deceit and breach of fiduciary duty. As in counts one and two, the plaintiffs allege in counts three and four that they have suffered damages as common stockholders due to the payment of advisory fees by the Funds to their investment adviser and the resulting conflict of interest. (Comp. ¶ 94, ¶ 99). For the reasons discussed above regarding counts one and two, counts four and five should have been brought as derivative claims. The complaint does not allege that the plaintiffs are minority shareholders or that defendants owe a duty to the plaintiffs different than the duty owed to all of the common stockholders. In addition, the only injuries alleged are the payment of the advisory compensation by the Funds and the diminution in value of the common stock. Any resulting injuries to the plaintiffs are derivative in nature. Therefore counts four and five are dismissed without prejudice.

## *Appendix C*

## *Motion for Class Certification*

### *A) Class Certification on Counts One, Two, Four, and Five*

The plaintiffs move to certify a plaintiff class and a defendant class. Since plaintiffs cannot bring direct claims in counts one, two, four, and five, they also cannot bring those claims as class representatives. "In short, a predicate to a party's right to represent a class is his eligibility to sue in his own right." *Mintz v. Mathers Fund, Inc.*, 463 F.2d 495, 499 (7th Cir. 1972). The plaintiffs' motion to certify a plaintiff and defendant class with respect to counts one, two, four, and five is denied on this ground.

### *B) Class Certification on Count Three*

Plaintiffs move for certification of a class including any person or entity who purchased shares in the Funds during the period of the statute of limitations, as well as in all other funds promoted or managed by Nuveen Advisory or John Nuveen that include the amount of APS leveraging in compensation of the fund's investment adviser. Pursuant to 15 U.S.C. § 80a-35(b), plaintiffs do not have standing to bring a § 36(b) claim on behalf of investment companies other than the Funds in which they are security holders, and therefore plaintiffs cannot represent a class for any funds other than the named defendants. In addition, a defendant class will not be certified, since Nuveen Advisory is the only potentially liable defendant.

To obtain class certification, the plaintiffs must satisfy the four requirements in Fed. R. Civ. P. 23(a), and one of the

requirements found in Fed. R. Civ. P. 23(b). It is unnecessary to consider whether the plaintiffs have met their burden with respect to Rule 23(a), for they have not met their burden with respect to Rule 23(b). Rule 23(b)(3), the section on which plaintiffs rely, requires that a class action is superior to other forms of adjudication. Plaintiffs have not shown that a class action is superior to other forms of adjudication.

Certification of a class is not necessary for full recovery by the plaintiffs on behalf of the Funds. A shareholder brings an action under § 36(b) on behalf of an investment company. Accordingly, "[a]ny recovery obtained in a § 36(b) action will go to the company rather than the plaintiff." *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 535 n.11 (1984). Recovery of damages resulting from the breach of fiduciary duty cannot exceed the amount of compensation paid by the investment company during a period not prior to one year before the action was commenced. 15 U.S.C. § 80a-35(b)(3). Thus regardless of whether plaintiffs' proposed class is certified, the plaintiffs can recover only on behalf of the Funds, and at most the amount of compensation paid to Nuveen Advisory within a year prior to the date this lawsuit was filed. Plaintiffs' proposed class would not result in a class action "superior to other available methods for the fair and efficient adjudication" of their § 36(b) claim. Fed. R. Civ. P. 23(b). Therefore plaintiffs' motion for class certification is denied.

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*Conclusion*

For the reasons discussed above, counts one, two, four, and five should have been brought as derivative claims and are accordingly dismissed without prejudice. The motion to dismiss plaintiffs' 36(b) claim under the ICA is denied with respect to Nuveen Advisory and granted with respect to all other defendants. In addition, plaintiffs' motion to certify a plaintiff class and a defendant class is denied.

**ENTER ORDER:**

s/ Elaine E. Bucklo
Elaine E. Bucklo
United States District Judge

Dated: March 30, 1999

## APPENDIX D — RELEVANT STATUTES

### Investment Company Act of 1940, 15 U.S.C. § 80a-1, *et seq.*

### § 80a-1. Findings and declaration of policy

* * *

**(b) Policy**

Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected —

> (2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

* * *

*Appendix D*

It is declared that the policy and purposes of this subchapter, in accordance with which the provisions of this subchapter shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

* * * *

*Appendix D*

**§ 80a-35. Breach of fiduciary duty**

* * *

**(b) Compensation or payments as basis of fiduciary duty; civil actions by Commission or security holder; burden of proof; judicial consideration of director or shareholder approval; persons liable; extent of liability; exempted transactions; jurisdiction; finding restriction**

For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, . . . . With respect to any such action the following provisions shall apply:

> (1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.

* * * *